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FISCAL YEAR END: 1231

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BUSINESS ADDRESS:

STREET 1: 1400 BROADFIELD BLVD

STREET 2: SUITE 100

CITY: HOUSTON

STATE: TX

ZIP: 77084-5163

BUSINESS PHONE: 7134926992

MAIL ADDRESS:

STREET 1: 1400 BROADFIELD BLVD

STREET 2: SUITE 100

CITY: HOUSTON

STATE: TX

ZIP: 777084-516

FORMER COMPANY:

FORMER CONFORMED NAME: FOUNTAIN OIL INC

DATE OF NAME CHANGE: 19950119

FORMER COMPANY:

FORMER CONFORMED NAME: ELECTROMAGNETIC OIL RECOVERY INC

DATE OF NAME CHANGE: 19920703

FORMER COMPANY:

FORMER CONFORMED NAME: ORS CORP /OK/

DATE OF NAME CHANGE: 19910515

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As filed with the Securities and Exchange Commission on February 12, 1999

File No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-1

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

CANARGO ENERGY CORPORATION

(Exact name of Registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

1311

(Primary Standard Industrial Classification Code Number)

91-0881481

(IRS Employer Identification No.)

1580, 727 - 7th Avenue S.W.,

Calgary, Alberta T2P 0Z5

Telephone (403) 777-1185

(Address and telephone number of principal executive offices)

Susan E. Palmer

CANARGO ENERGY CORPORATION

1400 Broadfield Boulevard, Suite 100

Houston, Texas 77084

Telephone (281) 492-6992

(Name, address and telephone number of agent for service)

Please forward a copy of all correspondence to:

Alan D. Jacobson, Esq.

Kelly Lytton Mintz & Vann LLP

1900 Avenue of the Stars, Suite 1450

Los Angeles, California 90067

Telephone (310) 277-5333

Approximate date of commencement of proposed sale to the public:

As soon as practicable after this Registration Statement becomes effective.

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If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. [x]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration for the same offering. []

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

CALCULATION OF REGISTRATION FEE

<TABLE>

<CAPTION>

| Maximum | | Proposed Maximum | |
|------------------------------|-------------------------|--------------------|-----------|
| Title of Each Class of | | Offering Price Per | |
| Offering | Amount of | Unit | Aggregate |
| Securities To Be Registered | Amount To Be Registered | | Price |
| Registration Fee | | | |
| <S> | | <C> | <C> |
| <C> | | | |
| Common Stock \$.10 par value | 21,264,643 shares | \$0.2813(1) | |
| \$5,981,744(1) | \$1,663.00 | | |

</TABLE>

(1) Determined in accordance with Rule 457(c) under the Securities Act of 1933, as amended, on the basis of the last sale price of the Common Stock on the Nasdaq National Market System on February 8, 1999.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

(ii)

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SUBJECT TO COMPLETION, DATED FEBRUARY 12, 1999

The information in this Prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the

Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

21,264,643 Shares
[Shares Minimum]

CANARGO ENERGY CORPORATION
COMMON STOCK

CanArgo Energy Corporation is offering 21,264,643 shares of its Common Stock on a best efforts basis directly to the public at a price of \$ per share. The closing price of the Company's Common Stock on the Nasdaq National Market System (symbol: GUSH) on February 11, 1999 was \$0.375 per share. The Company's Common Stock is also traded on the Oslo Stock Exchange (symbol: CNR).

YOU SHOULD CAREFULLY CONSIDER THE INFORMATION REGARDING RISKS ASSOCIATED WITH A PURCHASE OF THE COMPANY'S COMMON STOCK THAT ARE DESCRIBED UNDER THE CAPTION "RISK FACTORS" BEGINNING ON PAGE 5.

The Company is offering 21,264,643 shares (the "Maximum Offering") subject to selling at least shares (the "Minimum Offering"). All subscription payments will be deposited into an escrow account until the Minimum Offering is sold. When the Minimum Offering has been sold, the escrow will be terminated and the subscription proceeds will be delivered to the Company. Any proceeds from subsequent sales of shares up to the Maximum Offering will be delivered directly to the Company. If the Minimum Offering is not sold, all proceeds deposited in the escrow account will be promptly refunded in full, without interest and without any deduction of any kind.

Record holders as of , 1999 of the Company's Common Stock and of the Exchangeable Shares issued by the Company's subsidiary, CanArgo Oil & Gas Inc., will be given priority to purchase a number of shares being offered up to the number of shares they held on that date, provided that the Company receives their subscriptions in proper form prior to , 1999. Subject to such priority, subscriptions in proper form will be accepted in the order received. The Company reserves the right to reject any subscription in full or in part.

The offering will terminate on the earliest of (a) the date on which the Maximum Offering been sold; (b) , 1999, unless such date is extended by the Company to not later than , 1999; or (c) the date on which the Company terminates the offering.

<TABLE>
<CAPTION>

| to | | Price to Public | Underwriting Commissions | Proceeds Company |
|------------------------|-------------------|-----------------|-----------------------------|---------------------|
| | | ----- | ----- | ----- |
| <S> Per Share | | <C> \$ | <C> None | <C> \$ |
| | | ----- | | ----- |
| - Minimum Offering: | shares | \$ | None | |
| | | ----- | | ----- |
| - Maximum Offering: | 21,264,643 shares | \$ | None | \$ |
| | | ----- | | ----- |
| | | | | |

</TABLE>

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES

COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is , 1999

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[Inside Front Cover Page]

The United States Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for certain forward-looking statements. When used in this Prospectus, the words "estimate," "project," "anticipate," "expect," "intend," "believe," "hope," "may" and similar expressions, as well as "will," "shall" and other indications of future tense, are intended to identify forward-looking statements. Such forward-looking statements are based upon the current expectations of the Company and speak only as of the date made. These forward-looking statements involve risks, uncertainties and other factors that in some cases have affected the Company's historical results and could cause actual results in the future to differ significantly from the results anticipated in forward-looking statements made in this Prospectus. Important factors that could cause such a difference are discussed in this Prospectus, particularly in the "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections. You are cautioned not to place undue reliance on the forward-looking statements.

You should rely only on the information contained in this Prospectus. We have not authorized anyone to provide you with information that is different. The information in this Prospectus is current only as of the date of this Prospectus, regardless of the time this Prospectus is delivered to you or the time you purchase Common Stock. Such information could change and be different as of a later date.

This Prospectus is not an offer to sell, nor is it seeking an offer to buy, the Company's Common Stock in any jurisdiction where the offer or sale would be unauthorized or unlawful.

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SUMMARY

This summary highlights information contained elsewhere in this Prospectus. This summary is not complete and may not contain all of the information that you should consider before investing in the Common Stock. You should read the entire Prospectus carefully.

All share and per share amounts in this Prospectus have been adjusted to reflect a 1-for-2 reverse stock split of the Company's Common Stock effected in July 1998. All references to the "Company" are to CanArgo Energy Corporation and its consolidated subsidiaries.

THE COMPANY

CanArgo Energy Corporation is a Delaware corporation with interests in oil and gas properties in Eastern Europe, principally the Republic of Georgia. The Company completed in July 1998 a business combination with CanArgo Energy Inc., which is now known as CanArgo Oil & Gas Inc. and is a wholly owned subsidiary of the Company. The Company's principal asset is a 68.5% interest in Ninotsminda Oil Company Limited ("NOC"), a Cyprus corporation that is engaged in the development of the Ninotsminda oil field and other fields in the Republic of Georgia. The Company is directing substantially all of its efforts and available funds to the development of the Ninotsminda field and requires the proceeds of this offering to continue such activities. The Company has other interests in oil and gas properties in the Republic of Georgia, Ukraine and elsewhere, including North America.

The Company's principal executive offices are located at Suite 1580, Guinness House, 727 - 7th Avenue, S.W., Calgary, Alberta, Canada T2P 0Z5, and its telephone number is (403) 777-1185. See "BUSINESS."

THE OFFERING

<TABLE>

<S>

Priority to Record Stockholders.....
Exchangeable

, 1999

number of shares

subscription

,

Best Efforts Offering.....
subscriptions will be

Minimum Offering.....

Maximum Offering.....

Escrow Account.....
escrow account

</TABLE>

<C>

Record holders of the Company's Common Stock and of the

Shares issued by CanArgo Oil & Gas Inc. as of

will be given priority to purchase in the offering a

up to the number of shares they hold, provided their

documents are received in proper form by

1999.

Subject to the priority of Record Stockholders,

accepted in the order received.

shares (\$3,000,000).

21,264,643 shares (\$).

All subscription payments will be deposited into an

until the Minimum Offering is sold.

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<TABLE>

| | |
|-----------------------------|---|
| <S> Offering Period..... | <C> The offering will terminate on the earliest of |
|-----------------------------|---|

- sale of all the shares offered;
- , 1999 or, if extended,
 , 1999; or
- the date the Company terminates the offering.

not later than

| | |
|--|--|
| Use of Proceeds..... Offering to make Ninotsminda capital and | The Company will use the net proceeds of the Minimum a \$2,000,000 loan to NOC to be used to develop the field. Additional net proceeds will be used as working to invest in a refinery. See "USE OF PROCEEDS." |
|--|--|

| | |
|--------------------|------|
| Nasdaq Symbol..... | GUSH |
|--------------------|------|

| | |
|---------------------------------|-----|
| Oslo Stock Exchange Symbol..... | CNR |
|---------------------------------|-----|

| | |
|---|--|
| Risks..... The Company has proceeds of this should carefully | An investment in the Common Stock is very risky. experienced significant losses and requires the offering to finance its oil and gas projects. You read "RISK FACTORS." |
|---|--|

</TABLE>

SUMMARY CONSOLIDATED FINANCIAL DATA

The Company's operations have generated minimal revenues over the last five years, and during that time the Company has had substantial operating losses. The following consolidated financial data, which is unaudited, summarizes the Company's financial results for the nine month period ended September 30, 1998 and its financial position as of September 30, 1998.

<TABLE>

<CAPTION>

Nine Months Ended
September 30, 1998

(unaudited)

| | |
|--|--|
| <S> Total revenue Operating loss Net loss Net loss per common share Working capital Total assets | <C> \$ 520,000 (5,015,000) (4,790,000) (0.34) 6,717,000 48,077,000 |
|--|--|

| | |
|----------------------------------|------------|
| Notes payable and long-term debt | 896,000 |
| Minority interest | 3,385,000 |
| Stockholders' equity | 41,689,000 |

</TABLE>

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RISK FACTORS

An investment in the Company's Common Stock involves a high degree of risk. Prospective investors should carefully consider the following risk factors, as well as all other information in this Prospectus, before investing in the Common Stock. This Prospectus contains certain forward-looking statements that involve risks and uncertainties. Future events and the Company's actual results could differ materially from the results anticipated in these forward looking statements. Some of the important factors that might cause such a difference are discussed in the following risk factors.

THE COMPANY HAS INCURRED SUBSTANTIAL LOSSES AND HAS MINIMAL REVENUES.

The Company's oil and gas properties have produced minimal revenues. As a result, the Company has experienced recurring operating losses, and its current operations are not generating positive cash flows. For the quarter ended September 30, 1998, the Company reported revenues of \$375,000 and a net loss of \$781,000. On that date, the Company had an accumulated deficit since October 31, 1988, when it went through a quasi-reorganization, of \$62,296,000. The Company's ability to continue its operations is dependent upon generating funds from external sources and, eventually, generating positive cash flows from its operating activities. Without sufficient cash, the Company will not be able to finance its ongoing operations. The Company's financial statements are prepared on the basis that it will be able to continue to operate despite its need for cash. Thus, the financial statements do not reflect the reduction in the value of the Company's assets that would be expected if the Company ceased operations. See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

THE COMPANY HAS SIGNIFICANT SHORT-TERM CASH REQUIREMENTS.

Under the terms of the operative agreements governing its principal oil and gas projects, including its projects in the Republic of Georgia, the Company is required to provide or arrange for all capital and operating costs. The Company's working capital at December 31, 1998 was \$, which would be insufficient to fund the Company's planned operations past June 30, 1999.

NOC has entered into a \$6,000,000 Loan Agreement with the International Finance Corporation, with the proceeds to be used principally to fund the development of the Ninotsminda oil field, the Company's principal operation at the present time. The terms of the loan agreement require that the Company make or arrange a \$2,000,000 subordinated loan to NOC before the International Finance Corporation will disburse the loan, and the first disbursement must occur by June 30, 1999. The Company is conducting this offering in order to raise the funds to make the \$2,000,000 subordinated loan and to generate other funding, including additional working capital. See "USE OF PROCEEDS". If the Company is unable to arrange the \$2,000,000 loan, it may be unable to continue with the development of the Ninotsminda oil field. See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

THE COMPANY'S FUTURE IS DEPENDENT ON THE SUCCESS OF THE NINOTSMINDA OIL FIELD.

The Company's management has been directing substantially all of its

efforts and available funds to the development of the Ninotsminda oil field in the Republic of Georgia and some ancillary activities closely related to the Ninotsminda field project. This decision is based on management's assessment of the promise of the Ninotsminda field. In order to mitigate its investment risk, the Company has

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structured its development plans for the Ninotsminda field so that management can assess the commercial feasibility of the project at various stages. There is no assurance, however, that the Company's development plans for the Ninotsminda field, or any of the Company's oil and gas properties, will prove successful, that the Ninotsminda field will ever produce sufficient quantities of oil and gas to establish a viable operation, or that the Company will be able to market the oil and gas produced at a sufficiently high price to produce a profit and positive cash flow. The Company has not yet successfully developed and operated an oil field.

The Company has a number of other projects that are not being actively developed at this time. These projects involve unevaluated oil and gas properties which had a carrying value of \$11,451,000 at September 30, 1998. The risks associated with successfully developing unevaluated oil and gas properties are even greater than those associated with producing oil and gas properties. During 1997, the Company concluded that one venture it was developing could not be a successful commercial development and recorded an impairment charge for all of its assets related to that venture. In addition, the Company concluded that it would be unable to develop two other ventures successfully and recorded impairment charges for all of its assets related to these ventures.

THE COMPANY NEEDS LONG-TERM FUNDING.

It will take many years and substantial cash expenditures to develop the Company's oil and gas properties. The Company generally has the principal responsibility to provide financing for its oil and gas properties and ventures. The net proceeds of this offering, together with existing debt financing and funds expected to be generated by operations, are not expected to be sufficient to fund the Company's operations and development plans beyond June 2000. Accordingly, the Company will need to raise additional funds from public or private sources or enter into joint venture or similar arrangements with third parties in order to pay for project development costs. The issuance of additional equity securities would likely dilute the ownership interests of existing stockholders, and arrangements like joint ventures will reduce the Company's percentage interest in the relevant projects. Additional borrowing would increase interest expense and debt service requirements. The amount of additional financing the Company will require will depend upon a number of factors, including the success of this offering and the Company's development plans. The Company may not be able to obtain additional financing from any source if needed. If adequate funds are not available, the Company would be required to scale back or even suspend its operations.

THE COMPANY'S OIL AND GAS ACTIVITIES INVOLVE MANY RISKS.

The Company's exploration, development and production activities are subject to a number of factors and risks, many of which may be beyond the Company's control. First, the Company must successfully identify commercial quantities of recoverable oil and gas. The development of an oil and gas deposit can be affected by a number of factors, such as the size of the deposit, proximity to infrastructure, oil prices and government regulations, which are beyond the Company's control. The Company's activities can also be affected by a number of hazards, such as -

- - labor disputes;

- - unexpected or unusual geological conditions;
- - natural phenomena, such as bad weather and earthquakes;

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- - operating hazards, such as fires, explosions, blow-outs, pipe failures and casing collapses; and
- - environmental hazards, such as oil spills, gas leaks, ruptures and discharges of toxic gases.

Any of the hazards could result in damage, losses or liability for the Company. Company operations involving the rehabilitation of fields where less than optimal practices and technology were employed, as was often the case in Eastern Europe, carry increased risk for encountering some of these hazards.

The Company maintains insurance customary in the oil and gas industry relative to the scope of its operations. That insurance, however, does not cover all of the possible risks that are involved in oil and gas exploration, development and production.

THE COMPANY'S FOREIGN OPERATIONS ARE SUBJECT TO SPECIAL RISKS.

The Company's principal oil and gas properties, including the Ninotsminda field, are located in Eastern Europe. Development of these fields is subject to special risks and uncertainties such as:

- Political Instability - The governments of the Eastern European countries in which the Company operates were established relatively recently. The Company's operations typically involve partnerships or joint ventures with the local government or state-owned companies. As a result, the Company's operations could be adversely affected by political instability, changes in government institutions, personnel or policies, or shifts in political power. There is also the risk that new governments could seek to nationalize or otherwise take over the Company's oil and gas properties.
- Social and Economic Instability - Countries in Eastern Europe have experienced social and economic instability due to low standards of living, lack of infrastructure and technology, undeveloped legal and social institutions, conflicts with neighboring countries, and other factors. Such instability can make continued operations difficult or impossible.
- Deteriorating Infrastructure - Countries in Eastern Europe often either have underdeveloped infrastructures or, as a result of shortages of resources, have permitted infrastructure improvements to deteriorate. The lack of necessary infrastructure improvements can adversely affect operations. For example, the lack of a reliable power supply caused the drilling of a well in the Ninotsminda field to be suspended and the testing of a second well to be delayed.
- Currency Risks - Payment to the Company for oil and gas products sold in Eastern European countries may be in local currencies. Although the Company

currently sells its oil for U.S. dollars, it may not be able to continue to demand payment in hard currencies. Although most Eastern European currencies are presently convertible into U.S. dollars, there is no assurance that convertibility will continue. Even if currencies are convertible, the rate at which they convert

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into U.S. dollars is subject to fluctuation. The Company's ability to transfer currencies into or out of Eastern European countries may be restricted or limited.

OIL AND GAS PRICES ARE VOLATILE.

The Company's operations are significantly affected by changes in the market price of oil and gas. Prices for oil and natural gas are subject to wide fluctuations in response to changes in the supply and demand for oil and natural gas, weather conditions, domestic and foreign governmental regulations, the price and availability of alternative fuels, political conditions in the Middle East and elsewhere and overall economic conditions. The Company is unable to predict future oil and natural gas price movements with any certainty. The significant declines in oil prices during the past year have adversely affected the economics of the Company's projects. At current prices, the Company's revenue from its share of Ninotsminda field production is insufficient to cover production and depletion expenses associated with that production.

The price received for oil by NOC has generally been negotiated on the basis of the European spot price for Brent grade crude oil, less certain discounts for transportation and related charges. The price received by NOC has ranged from the full Brent price to Brent minus \$5.83 per barrel. The average discount from the spot price for Brent grade crude oil is approximately \$1.50 at this time because the particular buyers are transporting the oil shorter distances. If the Company is unable to attract buyers who need to transport the oil a relatively short distance, the Company will probably realize a lower net price from the sale of its oil. At today's European spot prices it would be uneconomic for the Company to sell its oil at a price incorporating a \$5.83 per barrel discount for transportation and related charges.

RESERVE INFORMATION IS UNCERTAIN.

Estimates of oil and natural gas reserves and their values by petroleum engineers are inherently uncertain. The estimates incorporate professional judgments not only about the quantities of crude oil and natural gas that exist in identified reservoirs but also about the portion that can be produced on an economically sound basis, the costs of production and the rate of extraction. This estimating process involves an evaluation of all available geological, engineering, production and economic data relating to each relevant oil and gas reservoir. The data relating to a particular reservoir may change substantially over time as a result of additional development activity, evolving production history, changing economic conditions, market price fluctuations, variations in production costs and other factors. In addition, the estimating process requires significant subjective judgments. As a result, different petroleum engineers evaluating the same data may reach substantially different results, and the same petroleum engineers evaluating data relating to a particular reservoir at various times may come to substantially different conclusions at different times. Actual production, revenue and costs for the Company's oil and gas reserves in the future will probably vary from those anticipated in the current estimates of the Company's oil and gas reserves, and the magnitude of those variations may be material.

OIL AND GAS OPERATIONS ARE SUBJECT TO EXTENSIVE REGULATION.

Governments at all levels -- national, regional and local -- regulate oil and gas activities extensively. Laws and regulations govern many aspects of the oil and gas business, including exploration, development, production, occupational health and safety, labor standards and environmental matters. The Company must comply with these laws and regulations. In recent years, governments have strengthened

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many of these laws and regulations, thereby increasing the burdens imposed on oil and gas companies in a number of ways, including the following:

- increasing the amount of potential liability associated with a particular event;
- expanding the categories of participants who may be responsible for the liabilities associated with that event;
- increasing reporting requirements; and
- subjecting operations to greater substantive regulation and greater requirements for advance regulatory clearance.

The trend is towards more burdensome regulation. This trend is particularly applicable in developing economies, such as those in Eastern Europe where the Company has its principal operations. In these countries, the evolution towards a more developed economy is often accompanied by the more burdensome regulations that typically exist in the more developed economies.

THE COMPANY IS INVOLVED IN LITIGATION.

The Company has acquired interests in various oil and gas properties from third parties who agreed to condition receipt of all or a portion of their payment for those interests upon the property achieving certain operating objectives, such as specified levels of production within specified periods. In certain cases, the properties have not achieved these objectives, with the consequence that the sellers did not receive the contingent payments. Two sellers who were denied some or all of their potential payments have instituted suits against the Company. In addition, some of the Company's co-venturers in oil and gas projects or the ventures themselves may assert claims against the Company with respect to the Company's decision not to proceed with the development of these projects. See "BUSINESS - Legal Proceedings".

THE COMPANY ENCOUNTERS INTENSE COMPETITION.

The oil and gas industry is highly competitive. The Company encounters competition from other oil and gas companies in many areas, including:

- acquisition of producing properties and undeveloped acreage;
- obtaining scarce resources, such as experienced personnel, drilling rigs or the services of oil field service companies, when in short supply; and
- sale of production.

The Company's competitors include integrated oil and gas companies, independent oil and gas companies, drilling and income programs, and individuals. Many of its competitors are large, well-established, well-financed

companies. These competitors may possess advantages in relation to the Company, including -

- larger and more experienced staffs;

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- greater capital resources;
- the ability to develop better information and to provide better analysis of available information;
- the ability to pay more for productive properties and exploratory prospects; and
- the human and financial resources to pursue a greater number of attractive opportunities.

The Company may not possess the capabilities required to compete successfully with its competitors in acquiring additional properties or in maximizing the development of its properties.

THE COMPANY IS DEPENDENT ON MANAGEMENT AND SERVICE CONTRACTORS.

The Company depends to a significant degree on key personnel and on its ability to attract and retain highly-skilled personnel. The loss of key personnel might adversely affect the Company's future results if the Company cannot attract suitable replacements.

David Robson, the Company's Chairman and Chief Executive Officer, does not have an employment agreement with the Company and could leave at will. He is the Company executive who has the most experience in the oil and gas industry and who has the most highly developed relationships in Eastern Europe. Should Mr. Robson leave the employ of the Company, his loss could have a material adverse effect upon the Company and its operations unless the Company were able to replace him with an executive of similar experience and skill.

The Company seeks to operate efficiently in Eastern European countries by engaging local service companies to operate and manage the Company's properties, including the Ninotsminda field. Although the Company has overall responsibility for the Ninotsminda project, the day-to-day operations, including personnel selection and supervision, are administered by the local service company. The lack of control over daily operations subjects the Company to increased risk of unauthorized actions.

EXISTING STOCKHOLDERS MAY EXPERIENCE DILUTION.

The number of shares being offered is equal to the number of outstanding shares of Common Stock and Exchangeable Shares. The public offering price is significantly less than the net tangible book value per share of the Common Stock of \$ at December 31, 1998. Holders of the Company's Common Stock and the Exchangeable Shares as of , 1999 are being given priority to purchase in this offering up to the number of shares they own. Those stockholders who do not purchase shares in this offering, or who purchase less than the number of shares they own, will experience dilution in their percentage ownership in the Company and in the net tangible book value per share of the shares they hold.

THE COMMON STOCK COULD BE DELISTED FROM THE NASDAQ STOCK MARKET.

The Company's Common Stock currently trades on the Nasdaq National Market System, as well as on the Oslo Stock Exchange. On September 30, 1998, Nasdaq advised the Company that its Common Stock would be delisted if the Common Stock did not attain a bid price of at least \$1.00 for ten consecutive days by the end of December 1998. The Common Stock failed to satisfy the minimum bid

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requirement by the end of December. The Company, however, requested a hearing regarding the proposed delisting by Nasdaq, which had the effect of delaying the proposed delisting until a hearing is held and a determination is made regarding delisting. The hearing will be held on February 26, 1999.

In an effort to satisfy Nasdaq's minimum price requirement, the Company will seek at the next annual meeting stockholder approval of a one-for-ten reverse stock split of the Common Stock. The reverse stock split would combine each ten issued and outstanding shares into one share. The Board of Directors believes that the reverse split should have the effect of increasing the bid price for the Common Stock to a level well in excess of the \$1.00 minimum required by Nasdaq. However, there is no assurance that the price of one share after the reverse split will be as high as the aggregate price of ten shares before the reverse split or that the stock price after the reverse split will meet the Nasdaq requirement.

The Company will seek a further delay of action by Nasdaq to delist the Common Stock until a stockholder meeting is held to vote on the proposed reverse stock split. The failure of the Company's stockholders to approve the reverse stock split could result in the delisting of the Common Stock.

If Nasdaq delists the Company's Common Stock from the National Market System, the Common Stock might thereafter trade in the United States either on the OTC Bulletin Board or through what is commonly referred to as the "pink sheets". In that event, Company stockholders would likely experience more difficulty in obtaining accurate and timely quotations of the price of the Common Stock, greater percentage spreads between bid and asked prices, and more difficulty and higher transactions costs when buying or selling the Common Stock.

If Nasdaq delists the Common Stock, then the Oslo Stock Exchange might also consider delisting the Common Stock from that exchange.

In addition, if Nasdaq delists the Common Stock from the National Market System, the penny stock rules of the Securities and Exchange Commission could apply to the Company's Common Stock. A "penny stock" is an equity security that is not listed on a national securities exchange or quoted on Nasdaq that has a market price of less than \$5.00 per share. The penny stock rules generally require, among other things:

- a suitability determination regarding a prospective purchaser of penny stock;
- the written consent of a prospective purchaser of penny stock prior to the transaction;
- delivery prior to a penny stock transaction of a disclosure document relating to the penny stock market;
- disclosure by the broker-dealer of the commissions payable to the broker-dealer and registered representative, current quotations for the penny stock security and, if true, that the broker-dealer is the sole market maker in the security and the control over that market that the broker-dealer would presumably possess; and
- monthly statements containing recent price information for penny stock held in a brokerage account and information on the limited market in penny stocks.

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As a result of the requirements imposed by the penny stock rules, broker-dealers may have limited interest in or capability for handling penny stock transactions. Consequently, if the Company's Common Stock becomes subject to the penny stock rules, stockholders may find it substantially more difficult to dispose of the Common Stock and may experience substantially increased transaction costs.

DURING THIS OFFERING, YOUR ABILITY TO SELL COMMON STOCK WILL BE IMPAIRED.

This offering may continue until , 1999. Although the Company's Common Stock is currently publicly traded on the Nasdaq National Market, until the offering is terminated investors who wish to sell their shares will have to compete for buyers with the Company's offering of shares pursuant to this Prospectus. It is unlikely that investors will be able to sell their shares on the open market during the offering for more than a price which together with the "spread" required by a market maker equals the price at which shares are being sold in this offering. The Company can give no assurance that the market price of the Common Stock will be at or above the public offering price during or after the offering.

THE OFFERING PROCEEDS WILL BE HELD IN AN ESCROW ACCOUNT.

All subscription payments will be deposited into an escrow account until the Minimum Offering is sold. If the Minimum Offering is not fully subscribed by , 1999, all monies deposited in the escrow account will be refunded to the subscribers, without interest and without any deduction for expenses. During the escrow period, subscribers will have no right to a return of their payments, and they will have no rights as stockholders until certificates are issued and delivered. See "THE OFFERING--Escrow of Minimum Proceeds."

FUTURE SALES OF COMMON STOCK COULD AFFECT ITS MARKET PRICE.

Open market sales of Common Stock that is outstanding at the start of this offering may adversely affect the market price of the shares during or after this offering. There are no material restrictions on the transferability of the approximately shares of Common Stock held by non-affiliates of the Company. Affiliates of the Company may sell shares subject to the volume limitations set forth in Rule 144. See "SHARES ELIGIBLE FOR FUTURE RESALE."

FUTURE STOCK ISSUANCES COULD HAVE ANTI-TAKEOVER EFFECTS.

The Company's Board of Directors may issue additional shares of Preferred Stock and Common Stock without any prior approval by the stockholders. Holders of outstanding shares have no right to purchase a pro rata portion of additional shares of Common or Preferred Stock issued by the Company. The issuance of additional shares could have an anti-takeover effect under certain circumstances.

In the case of Preferred Stock, the Board of Directors can establish the voting power, preferences, rights and limitations of each class or series it creates in the future. For example, the Board of Directors can create a series of Preferred Stock with disproportionate voting power or with the right to vote separately as a class on important corporate matters, like mergers or the election of directors. A series of Preferred Stock can also be convertible into a large number of shares of Common Stock under specified circumstances or have other terms that could make the acquisition of a controlling interest in the Company more difficult or more expensive.

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Additional shares of either Preferred Stock or Common Stock could be

sold privately to purchasers who could be expected to support incumbent management in opposing an unsolicited attempt to obtain control of the Company. The issuance of additional shares of Preferred or Common Stock could deprive stockholders of the opportunity to benefit from offers to take control of the Company that stockholders might view as favorable. If the one-for-ten reverse stock split is approved by the stockholders and implemented, there would be after completion of this offering (and assuming no other significant transactions) at least 45,000,000 authorized but unissued shares of Common Stock available for issuance at the discretion of the Board of Directors.

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THE OFFERING

GENERAL

The Company is offering up to 21,264,643 shares of its Common Stock on a "best efforts" basis directly to the public at a subscription price of \$ per share. Subject to a priority being afforded to holders of Company Common Stock and of Exchangeable Shares issued by the Company's subsidiary, CanArgo Oil & Gas Inc., the shares will be sold to purchasers in the order in which their subscriptions are received and accepted.

The offering will terminate on the earliest of:

- the date on which all 21,264,643 shares have been sold;
- , 1999, unless such date is extended by the Company to not later than , 1999; or
- the date on which the Company terminates this offering.

ESCROW OF MINIMUM PROCEEDS

This offering is being made directly by the Company on a "minimum/maximum" basis. The Minimum Offering is shares (\$3,000,000) and the Maximum Offering is 21,264,643 shares (\$). Until at least the Minimum Offering can be closed, all subscription payments will be deposited into an escrow account established at by Signature Stock Transfer, Inc., which is acting as the Company's Subscription Agent and as Escrow Agent. When subscriptions for shares representing at least the Minimum Offering have been received and accepted, but not earlier than , 1999 when the priority rights being afforded holders of Company Common Stock and of Exchangeable Shares will expire, the escrow will terminate. At that time, share certificates will be issued and delivered to the subscribers, and the proceeds from the sale of those shares will be disbursed to the Company. Proceeds from additional sales of shares up to the Maximum Offering will be disbursed to the Company upon issuance and delivery of share certificates to the subscribers. If the Minimum Offering is not sold by the date this offering is terminated, all proceeds deposited in the escrow account will be promptly refunded in full, without interest and without any deduction of any kind.

RECORD STOCKHOLDER PRIORITY

Holders of record of the Company's Common Stock and of the Exchangeable Shares issued by CanArgo Oil & Gas Inc., a subsidiary of the Company, as of , 1999 ("Record Stockholders") have the first right to subscribe for the shares of Common Stock being offered in this offering. Each Record Stockholder will have the right to subscribe for and purchase a number of shares of Common Stock up to the number of shares of Common Stock and Exchangeable Shares held by the Record Stockholder on the record date, so long as the Subscription Agent receives properly completed subscription documents and payment for such shares from the Record Stockholder no later than 5:00 p.m. Central Time on

, 1999.

The Company will concurrently solicit subscriptions for shares from the general public. Subject to the priority being accorded to the Record Stockholders to subscribe prior to , 1999,

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subscriptions will be processed in the order received and accepted until all 21,264,643 shares are sold or until the Company terminates the offering.

If you are a beneficial owner of shares held in the name of someone else who is acting as your nominee (for example, shares held by a bank or brokerage firm for your account), and you want your subscription to receive priority treatment, you must instruct the nominee in whose name your shares are registered to subscribe for shares on your behalf within the time period described above. If you are a broker, depository or nominee that holds shares of the Common Stock for the account of others, you should provide copies of this Prospectus to the beneficial owners. You should carry out their intentions should they desire to purchase shares in this offering.

SUBSCRIPTION PROCEDURE

To subscribe for shares in the offering, you must complete, sign and return a Subscription Agreement and include full payment for the shares subscribed. You must pay for the shares subscribed in U.S. dollars by check or bank draft drawn on a United States bank, or postal, telegraphic or express money order payable to "Signature Stock Transfer, Inc. , as Subscription Agent." The subscription price will be considered to have been received when:

- - The Subscription Agent receives a certified check, bank cashier's check or bank draft drawn on a United States bank;
- - The Subscription Agent receives a postal, telegraphic or express money order; or
- - An uncertified check has "cleared".

Subscribers are urged to consider paying the subscription price by means of certified or bank cashier's checks or money orders. Payments made by personal or company checks that have not been certified will be considered received only upon clearance. Even domestic checks that have not been certified may take more than five business days to clear, so subscribers intending to pay with uncertified personal or company checks are urged to make payment sufficiently in advance of the termination date or the date on which the priority being accorded the Record Stockholders terminates to ensure that payment is deemed received prior to such date. The Escrow Agent must receive the completed Subscription Agreements and payments by 5:00 p.m., Central _____ Time, on , 1999, unless extended by the Company.

We suggest, for your protection, that you deliver your subscription documents to the Escrow Agent by overnight or express mail courier. If you mail the documents, we suggest you use registered mail. You should deliver the Subscription Agreement and payment to:

Once delivered, you may not revoke or change your subscription, even if the market price for the Common Stock falls below the subscription price of \$ per share during the offering.

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The Company may reject any subscription in full or in part. The subscription price paid with subscriptions that are not accepted for any reason will be promptly returned without interest or any deduction of any kind. Subscriptions accompanied by an overpayment which are otherwise in order will be accepted and a check will be mailed to the subscriber for the amount of the overpayment.

The Subscription Agent will deliver certificates for shares subscribed promptly after the Minimum Offering has been sold and promptly after later subscriptions have been accepted. Subscribers will not be deemed to be holders of the shares of Common Stock they are purchasing until the stock certificates representing those shares are issued and delivered.

The Company will decide all questions as to the validity, form and eligibility of subscriptions, and the Company's interpretation of the terms and conditions of the offering will be final and binding. The Company may waive any irregularities in any subscription. The Company is not required to notify you of any defect or irregularity in your subscription.

Prospective subscribers with questions or needing assistance concerning the procedures for subscribing for shares should call Susan E. Palmer, who is the Company Secretary, at (281) 492-6992.

DETERMINATION OF OFFERING PRICE

The Company has determined the public offering price of the shares based upon the recent trading history of the Common Stock on the Nasdaq National Market and the Oslo Stock Exchange. On , 1999, the last sale price for Common on the Nasdaq National Market System was \$.

The public trading price of the Common Stock may differ from the subscription price of \$ during the offering. If that is the case, persons interested in acquiring Common Stock are unlikely to purchase shares on Nasdaq or the Oslo Exchange for more than \$ if they can purchase shares at that price directly from the Company in this offering. For that reason, stockholders who wish to sell their shares during the offering will probably be required to ask a price that, when coupled with the "spread" required by a market maker, is no more than \$ per share.

The Company's net tangible book value per share as of September 30, 1998 was \$1.97 per share. Since this amount exceeds the public offering price of \$ per share by a substantial amount, purchasers in this offering will not experience dilution of the subscription price they pay in this offering in relation to net tangible book value per share. Record Stockholders who do not subscribe in this offering for the same number of shares as they own will, however, experience dilution in the net tangible book value of the shares they hold.

SALES REPRESENTATIVE

The Company will only effect offers and sales of shares through its designated sales representative, Mr. , who also serves as the Company's and is a member of the Board of Directors. Mr. will not receive, directly or indirectly, any commissions, remuneration, or any other compensation based on transactions in securities. Mr. is registered as a sales representative for this offering in those jurisdictions in which such registration is required.

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USE OF PROCEEDS

The net proceeds to the Company from this offering, after deducting the estimated expenses of the offering of approximately \$, are expected to be \$ upon completion of the Minimum Offering and \$ upon completion of the Maximum Offering. The Company intends to use the net proceeds for the following purposes, which are listed in their order of importance:

<TABLE>
<CAPTION>

| | Minimum Offering ----- | Maximum Offering ----- |
|--|------------------------------|------------------------------|
| <S> | <C> | <C> |
| Subordinated loan to Ninotsminda Oil Company (1) | \$2,000,000 | \$2,000,000 |
| Working capital (2) | ----- | ----- |
| Investment in refinery (3) | 0 | 860,000 |

</TABLE>

- (1) Under the terms of a \$6,000,000 loan agreement between Ninotsminda Oil Company and the International Finance Corporation, the Company must make or arrange a \$2,000,000 subordinated loan to Ninotsminda Oil Company as a condition to disbursement of the \$6,000,000 loan. See "BUSINESS - Ninotsminda Oil Field - International Finance Corporation Loan".
- (2) To be used for general corporate overhead and the development of fields and prospects.
- (3) To exercise the Company's option to purchase an additional 11.1% interest in an oil refinery in Georgia. See "BUSINESS - Ninotsminda Oil Field - Ancillary Projects - Refinery".

Pending such uses, the net proceeds of this offering will be invested in short-term, investment-grade, interest-bearing securities.

The Company currently anticipates that the net proceeds from the Minimum Offering, together with amounts available under its loan from the International Finance Corporation and cash generated from operations and the sale of excess equipment will be sufficient to satisfy its operating needs for approximately the twelve months following the completion of the Minimum Offering.

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MARKET FOR COMMON STOCK AND DIVIDEND POLICY

MARKET FOR COMMON STOCK

The Company's Common Stock is traded under the symbol "GUSH" on the Nasdaq National Market System and under the symbol "CNR" on the Oslo Stock Exchange. The following table sets forth the high and low sales prices and the average daily trading volume of the Common Stock on Nasdaq and the OSE. Nasdaq data is from The Nasdaq Stock Market and OSE data is from published financial sources.

<TABLE>
<CAPTION>

| NASDAQ | OSE(1) |
|--------|--------|
| ----- | ----- |

| | HIGH | LOW | AVERAGE DAILY VOLUME | HIGH | LOW | AVERAGE DAILY VOLUME |
|----------------------|----------|---------|----------------------------|----------|---------|----------------------------|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| FISCAL QUARTER ENDED | | | | | | |
| March 31, 1997 | \$ 14.25 | \$ 8.75 | 49,338 | \$ 14.22 | \$ 8.96 | 210,918 |
| June 30, 1997 | 10.13 | 7.81 | 21,109 | 9.52 | 7.92 | 103,931 |
| September 30, 1997 | 9.13 | 4.84 | 23,603 | 8.86 | 4.96 | 157,173 |
| December 31, 1997 | 7.00 | 1.19 | 62,684 | 6.46 | 1.66 | 284,036 |
| March 31, 1998 | 2.63 | 1.44 | 27,015 | 2.38 | 1.60 | 153,177 |
| June 30, 1998 | 2.25 | 1.00 | 15,520 | 2.13 | 1.20 | 65,617 |
| September 30, 1998 | 1.81 | 0.47 | 10,266 | 1.60 | 0.53 | 24,924 |
| December 31, 1998 | 0.81 | 0.22 | 34,570 | 0.67 | 0.20 | 27,493 |

(1) Sales prices on the OSE were converted from Norwegian kroner into United States dollars on the basis of the daily 10:00 a.m. exchange rate for buying United States dollars with Norwegian kroner announced by the Central Bank of Norway.

On March , 1999 the closing price of the Common Stock on Nasdaq was \$ per share. Nasdaq has notified the Company that its Common Stock may be delisted because the stock has not achieved the minimum bid price required by Nasdaq. See "RISK FACTORS -- The Common Stock could be delisted from the Nasdaq Stock Market."

On February 3, 1999, 19,381,120 shares of Common Stock were outstanding and held of record by 3,856 stockholders. In addition, 1,073,763 Exchangeable Shares issued by CanArgo Oil & Gas Inc., a subsidiary of the Company, were outstanding on that date. Each Exchangeable Share may be exchanged for one share of Common Stock. See "DESCRIPTION OF CAPITAL STOCK."

DIVIDEND POLICY

The Company has not paid any cash dividends on its Common Stock. The Company currently intends to retain future earnings, if any, for use in its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future. The payment of future dividends, if any, will depend, among other things, on the Company's results of operations and financial condition and on such other factors as the Company's Board of Directors may, in its discretion, consider relevant. Under its loan agreement with International Finance Corporation, Ninotsminda Oil Company's ability to transfer funds to CanArgo Energy Corporation and its affiliates is severely restricted. See "MANAGEMENT'S

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DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" and Note ____ of the Company's Consolidated Financial Statements. In addition, the Company may not pay dividends on its Common Stock unless its subsidiary, CanArgo Oil & Gas Inc., is able to pay and simultaneously pays an equivalent dividend on the Exchangeable Shares issued by that subsidiary. See "DESCRIPTION OF CAPITAL STOCK."

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CAPITALIZATION

The following table sets forth the capitalization of the Company as of September 30, 1998. The table also presents such capitalization as adjusted to reflect the Minimum Offering and the Maximum Offering and, in each case, the

application of the estimated net proceeds thereof. You should read this information together with the Company's financial statements.

AS OF SEPTEMBER 30, 1998 (UNAUDITED)

<TABLE>

<CAPTION>

| | Actual | As adjusted for | |
|--|---------------|------------------|------------------|
| | | Minimum Offering | Maximum Offering |
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Long-term debt (1) | \$ 895,500 | | |
| Stockholders' equity | | | |
| Preferred stock | -- | | |
| Common stock: | | | |
| issued and outstanding: | | | |
| 11,223,744 shares actual; | | | |
| shares as adjusted | | | |
| for Minimum Offering; | | | |
| 32,488,387 shares as | | | |
| adjusted for Maximum | | | |
| Offering (2) | | | |
| 9,970,900 additional | | | |
| shares issuable without | | | |
| receipt of further | | | |
| consideration (3) | 2,119,464 | | |
| Capital in excess of par value | 101,865,441 | | |
| Accumulated deficit since October 31, 1988 | (62,296,130) | | |
| | ----- | | |
| Total stockholders' equity | 41,688,775 | | |
| | ===== | | |
| Total capitalization | \$ 42,584,275 | | |

</TABLE>

-
- (1) The "as adjusted" long-term debt reflects the amount committed under the Company's loan agreement with the International Finance Corporation.
- (2) Excludes 2,765,511 shares reserved for issuance upon the exercise of outstanding options and warrants and upon achievement of certain performance objectives by an oil and gas project.
- (3) The 9,970,900 additional shares issuable without receipt of further consideration represent shares issuable upon exchange of Exchangeable Shares issued or issuable by CanArgo Oil & Gas Inc., the Company's subsidiary. See "DESCRIPTION OF CAPITAL STOCK."

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SELECTED CONSOLIDATED FINANCIAL DATA

The following tables set forth selected consolidated financial data taken from the Company's financial statements which appear in this Prospectus beginning at page F-1. CanArgo Oil & Gas Inc. and its subsidiary, Ninotsminda Oil Company Limited, were purchased by the Company in July 1998. Their financial results are included in the Company's consolidated financial results from July 16, 1998. CanArgo Oil & Gas Inc. is a wholly owned subsidiary and NOC is a 68.5% owned subsidiary of the Company.

You should read the complete financial statements and related notes of these companies which begin on page F-1 of this Prospectus. You should also read the section "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" for an explanation of the Company's financial results.

CANARGO ENERGY CORPORATION

<TABLE>
<CAPTION>

| NINE MONTHS ENDED 9/30/97 ----- | NINE MONTHS ENDED 9/30/98 ----- | TWELVE MONTHS ENDED 10/31/93 ----- | TEN MONTHS ENDED 8/31/94 ----- | TWELVE MONTHS ENDED 8/31/95 ----- | TWELVE MONTHS ENDED 8/31/96 ----- | FOUR MONTHS ENDED 12/31/96 ----- | TWELVE MONTHS ENDED 12/31/97 ----- |
|---|---|--|--|---|---|--|--|
|---|---|--|--|---|---|--|--|

(unaudited)

(in \$1,000 except for per share amounts)

| <S> <C> Total revenue 173 | <C> <C> 520 | <C> 190 | <C> 3 | <C> 625 | <C> 35 | <C> 17 | <C> 313 |
|---------------------------------------|-------------------|------------|----------|------------|-----------|-----------|------------|
| Operating loss (6,645) | (5,015) | (1,547) | (1,466) | (7,882) | (5,640) | (2,983) | (29,090) |
| Other income (expense) 783 | 171 | 252 | (366) | 312 | (854) | 361 | 1,202 |
| Net loss (5,675) | (4,790) | (1,295) | (1,832) | (7,600) | (6,494) | (2,604) | (27,683) |
| Net loss per common share - (0.51) | (0.34) | (0.44) | (0.90) | (1.82) | (1.04) | (0.28) | (2.47) |
| basic and diluted | | | | | | | |
| Working capital (deficit) 17,753 | 6,717 | (446) | 1,145 | 4,188 | 16,925 | 30,382 | 13,971 |
| Total assets 49,933 | 48,077 | 4,528 | 4,944 | 10,710 | 32,089 | 55,375 | 37,434 |
| Notes payable and long-term -- | 896 | 158 | 163 | -- | 300 | -- | -- |
| debt | | | | | | | |
| Minority interest 19 | 3,385 | -- | -- | -- | -- | -- | -- |
| Stockholders' equity 48,787 | 41,689 | 3,707 | 4,181 | 9,608 | 30,505 | 53,245 | 26,779 |
| Cash dividends per common -- | -- | -- | -- | -- | -- | -- | -- |
| share | | | | | | | |

</TABLE>

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MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

This Prospectus contains certain forward-looking statements that involve risks and uncertainties. Forward looking statements can be identified by such words as "may", "will", "should", "expect", "intend", "plan", "estimate" and similar words. Future events and the Company's actual results could differ materially from the results anticipated by the forward-looking statements. Important factors that could cause such a difference are discussed in this Prospectus, in particular in the "Risk Factors" section. You are cautioned not to place undue reliance on the forward-looking statements.

The following discussion should be read together with the Company's consolidated financial statements which appear in this Prospectus.

LIQUIDITY AND CAPITAL RESOURCES

The Company continued its program to reduce expenses and limit investment in oil and gas ventures which began in the fourth quarter of 1997. The Company continues to incur general and administrative costs and project costs which were committed to prior to the combination with CanArgo Oil & Gas in July 1998 (the "Transaction"). The Company expects that the ongoing costs from the restructuring of the Company will finally be eliminated by July 1999.

Capital expenditures by Ninotsminda Oil Company ("NOC") in 1998 are currently projected to be approximately \$7,350,000 of which \$3,990,000 has been spent at September 30, 1998. Current development plans for the Ninotsminda Field in 1999 include the drilling of a minimum of three development wells plus five major workovers of existing wells for a total budgeted cost of \$8,415,000. As a considerable amount of infrastructure has been put in place for the Ninotsminda Field by Georgian Oil, subsequent increases in oil production are not expected to increase infrastructure costs substantially. No assurance can be given, however, that NOC's development plan will increase production or that operating revenues will exceed operating expenses.

As of September 30, 1998, the Company had working capital of \$6,717,000, compared to working capital of \$13,971,000 as of December 31, 1997. The \$7,254,000 decrease in working capital from December 31, 1997 to September 30, 1998 reflects principally expenditures on 1998 acquisition costs relating to the Transaction, restructuring costs associated with the program to reduce overall costs, operating activities, including general and administrative expenses and direct project costs, and capital expenditures relating to the Ninotsminda Field. The decrease in cash and cash equivalents was partially offset by an increase in accounts receivable.

Cash and cash equivalents decreased \$8,073,000 from \$14,164,000 at December 31, 1997 to \$6,091,000 at September 30, 1998, primarily as a result of expenditures on operating activities and activities relating to the Transaction. Cash and cash equivalents include cash held by NOC of \$1,495,000 which the Company has the limited ability to withdraw. The general and administrative expenses of \$2,721,000, direct project costs of \$1,012,000, acquisition costs of \$1,215,000, and investment in property, plant and equipment of \$1,896,000 and oil and gas property of \$1,224,000 incurred during the first nine months of 1998 all involved principally cash items. The use of cash to fund expenditures was partially offset by the release of restrictions that had applied to \$1,133,000 of the Company's previously restricted cash.

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These cash balances are not sufficient to cover the Company's

working capital requirements and capital expenditure plans during the remainder of 1998 and through 1999. To avoid cutbacks to the Company's capital expenditure plans, the Company is seeking the funds necessary to cover its working capital and capital expenditure plans. Potential sources of funds include project financing, additional equity and joint ventures with other companies. Based on continuing discussions with major stockholders, investment bankers, potential partners and other oil companies, the Company believes that such required funds will be available. However, there is no assurance that such funds will be available, and if available, will be offered on attractive or acceptable terms. In October 1998, the International Finance Corporation ("IFC") approved, subject to the execution of definitive legal documentation, a \$6,000,000 convertible loan to NOC. The Company is not obligated to provide additional capital to any of its projects with the exception of its share of a \$2,000,000 shareholders supporting loan to NOC upon completion of IFC financing. However there is no assurance that the non-controlling shareholder in NOC will contribute its share of the shareholder supporting loan, in which case the Company maybe required to source additional capital to meet the IFC's funding requirements.

Accounts receivable increased from nil at December 31, 1997, when the minimal amount of accounts receivable were classified within other current assets, to \$454,000 at September 30, 1998, primarily as a result of \$120,000 relating to oil revenue. In addition, \$92,000 of receivables which had previously been included within other current assets were reclassified as accounts receivable at September 30, 1998.

Advances to operator increased from nil at December 31, 1997 to \$1,764,000 at September 30, 1998 as a result of advances to the operator for the Ninotsminda Field.

Inventory increased from nil at December 31, 1997 to \$170,000 at September 30, 1998 as result of placing oil produced at the Ninotsminda Field in storage.

Other current assets decreased from \$762,000 at December 31, 1997 to \$345,000 at September 30, 1998, primarily as a result of the collection of \$234,000 on claims that had been included within other current assets, the amortization of prepaid expenses amounting to \$264,000, and the reclassification of remaining receivables during that nine month period, partly offset by the prepayment of insurance premiums amounting to \$155,000 in the third quarter of 1998.

The \$8,547,000 decrease in current liabilities during the nine months ended September 30, 1998 is primarily attributable to a \$9,018,000 decrease in accrued liabilities, which in turn is primarily attributable to payment of various liabilities accrued at December 31, 1997 relating to the payment of bank debt and related interest incurred by Kashtan Petroleum Ltd. ("Kashtan"), the entity operating the Lelyaki Field project, Lelyaki Field project closedown costs, employee termination costs and payment for oilfield equipment; partly offset by increased accounts payable due to the Transaction.

Property and equipment, net, increased from \$5,942,000 at December 31, 1997 to \$7,161,000 at September 30, 1998, primarily as a result of the Transaction.

Oil and gas properties, net increased from \$1,479,000 at December 31, 1997 to \$26,729,000 at September 30, 1998 primarily as a result of the Transaction. The effect of the Transaction was partly offset by writedowns of the Company's oil and gas properties associated with the Sylvan Lake project aggregating \$900,000 as a result of a decline of heavy oil prices during the first nine months of 1998 and the application of the quarterly full cost ceiling test.

during the nine month period ended September 30, 1998 from \$5,387,000 at December 31, 1997 to \$5,362,000 at September 30, 1998. The decrease reflects the Company's equity in the loss of Boryslaw Oil Company ("BOC"), the entity developing the Stynawske Field project, for the first nine months of 1998, which was partly offset by the Company's advances to BOC in the first nine months of 1998.

The balance of \$5,387,000 as of December 31, 1997 and \$5,362,000 as of September 30, 1998 in investments in and advances to oil and gas ventures, net, relates solely to BOC and the Stynawske Field project. The Company has the responsibility for arranging financing for this venture and, unless third-party financing can be arranged, the Company might have to supply the capital to finance operations until the venture generates positive cash flow, which would have the effect of increasing investments in and advances to oil and gas ventures. The amount of such advances may be greater than the amount of the operating losses recognized by the Company, which would cause such net investment balances to increase. Such investments at the initial stages of development are essentially unevaluated oil and gas properties, and such costs may not be recovered if the venture is not successful. No assurance can be given that the Company will either be able to arrange third-party financing for such venture or have sufficient resources to fund the capital and operating needs of the venture or that the venture will be successful.

The Company is aware that its recent stock price does not meet the minimum bid price requirements of the Nasdaq National Market. The Company believes, based on its net book value of \$1.97 per share at September 30, 1998, recent business progress and improving market conditions, that the current situation should be temporary. Nevertheless, the Company is corresponding with the Nasdaq National Market and is prepared to be proactive in protecting shareholder liquidity.

As a result of the Company's suspension of activities relating to Kashtan, Intergas JSC ("Intergas"), the entity developing the Maykop Field project, and the Gorisht-Kocul joint venture, the Company may be subject to contingent liabilities in the form of claims from those ventures and other participants therein. The Company has been advised that Intergas and another shareholder of Intergas are considering asserting such claims. The Company's management is unable to estimate the range that such claims, if any, might total. However, if any claims were determined to be valid, they could have a material adverse effect on the Company's financial position, result of operations and cash flows. Any such claims may be adjudicated in host country forums under host country law.

The Company has contingent obligations and may incur additional obligations, absolute or contingent, with respect to the acquisition and development of oil and gas properties and ventures in which it has interests that require or may require the Company to expend funds and to issue shares of its Common Stock. The Company believes that it has no further obligation to fund any operations of Kashtan or Intergas. At September 30, 1998, the Company had contingent obligations, subject to the satisfaction of conditions relating to the achievement of specified Stynawske Field project performance standards, involving 187,500 shares. As the Company develops current projects and undertakes other projects, significant additional obligations may be incurred.

Development of the oil and gas properties and ventures in which the Company has interests involves multi-year efforts and substantial cash expenditures. Full development of the Company's oil and gas properties and ventures will require the availability of substantial additional financing from external sources. The Company also intends where opportunities exist to farm-out portions of its interests in oil and gas properties and ventures to entities that can provide such financing. The Company generally has

the principal responsibility for arranging financing for the oil and gas properties and ventures in which it has an interest. There can be no assurance, however, that the Company or the entities that are developing the oil and gas properties and ventures will be able to arrange the financing necessary to develop the projects being undertaken or to support the corporate and other activities of the Company or that such financing as is available will be on terms that are attractive or acceptable to or are deemed to be in the best interest of the Company, such entities and their respective stockholders or participants.

Ultimate realization of the carrying value of the Company's oil and gas properties and ventures will require production of oil and gas in sufficient quantities and marketing such oil and gas at sufficient prices to provide positive cash flow to the Company, which is dependent upon, among other factors, achieving significant production at costs that provide acceptable margins, reasonable levels of taxation from local authorities, and the ability to market the oil and gas produced at or near world prices. In addition, the Company must mobilize drilling equipment and personnel to initiate drilling, completion and production activities. The Company has plans to mobilize resources and achieve levels of production and profits sufficient to recover its carrying value. However, if one or more of the above factors, or other factors, are different than anticipated, these plans may not be realized, and the Company may not recover its carrying value. The Company will be entitled to distributions from the various properties and ventures in which it participates in accordance with the arrangements governing the respective properties and ventures.

The \$339,000 due to affiliated entity at September 30, 1998 relates to a loan from Terrenex Acquisition Corporation. Long term debt at September 30, 1998 of \$896,000 relates to a loan and an advance to NOC from NOC's non-controlling shareholder. Minority interest in subsidiaries at September 30, 1998 of \$3,385,000 relates to the 44.1% interest of the non-controlling shareholder in NOC.

Year 2000 Compliance

The Year 2000 problem is the result of computer programs being written using two digits to define the applicable year. If not corrected, any programs or equipment that have time sensitive components could fail or create erroneous results. The Company has completed a preliminary review of its existing systems and has upgraded its accounting information systems to software that purports to be Year 2000 compliant. The majority of other software and hardware currently used by the Company is believed to be Year 2000 compliant and the cost of converting any non-compliant systems is not expected to be material to the Company's financial condition. Although the Company does not expect to incur significant additional expenditures to address Year 2000 issues, there can be no assurance that this will be the case.

The Company currently has limited information concerning the Year 2000 compliance status of its suppliers of goods and services including the status of its contract operator in the Republic of Georgia. The Company intends to initiate formal communications with all of its significant suppliers with respect to such persons' Year 2000 compliance and status. Should remedial efforts be required, the inability of the Company or its principal suppliers to become Year 2000 compliant in a timely manner could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows. Should it become apparent that significant remedial action is required by the Company's suppliers, a contingency plan will be developed by January 31, 1999.

New Accounting Standards

In 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130, Reporting

Comprehensive Income and SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information and in 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 130 became effective on January 1, 1998; however, the Company had no comprehensive income other than net income. SFAS No. 131 and SFAS No. 133 will be adopted in the annual financial statements for 1998 and 1999, respectively, and based on present circumstances would not have any material effect on the Company's financial statements.

RESULTS OF OPERATIONS

The Company has typically acquired its interests in oil and gas properties through interests in joint ventures, partially owned corporate and other entities and joint operating arrangements. The Company's interest in the assets and liabilities of unconsolidated entities is reflected on the Company's consolidated balance sheet on a net basis as investment in and advances to oil and gas ventures. The Company's share of revenue, other income and expenses of unconsolidated entities is reported in the Company's consolidated statement of operations as income or loss from equity investment in oil and gas ventures. The Company's interest in the cash flow of unconsolidated entities is reported in the Company's consolidated statement of cash flows as distributions from or investment in or advances to oil and gas ventures. Interests acquired in certain joint ventures, partnerships and production sharing, working interest and other arrangements are proportionately consolidated. The Company will report the same stockholders' equity and net income or loss whether it accounts for various oil and gas ventures using the equity method or on a consolidated basis.

Nine month periods ended September 30, 1998 and 1997

The Company recorded operating revenue of \$520,000 during the nine month period ended September 30, 1998 compared with \$173,000 for the nine month period ended September 30, 1997. Revenue of \$331,000 in the nine month period ended September 30, 1998 related to oil production of 151,000 barrels ("bbls") gross (54,600 bbls net to NOC) from the Ninotsminda Field subsequent to the Transaction less net production placed in storage of 34,500 bbls. and revenue of \$177,000 related to oil production from the Sylvan Lake property in Alberta, Canada. Revenue for the nine month period ended September 30, 1997 primarily related to oil production from the Sylvan Lake property. Net sales from the Ninotsminda Field before prior months' oil price adjustments averaged \$11.50 per barrel. The Company also recorded a nominal amount of revenue during nine month period ended September 30, 1998 from the sale of electrically enhanced oil recovery ("EEOR") equipment. There was no revenue from the sale of EEOR equipment for the nine month period ended September 30, 1997.

The operating loss for the nine month period ended September 30, 1998 amounted to \$5,015,000, compared with \$6,645,000 for the nine month period ended September 30, 1997. Lease operating expenses increased to \$477,000 during the nine month period ended September 30, 1998, as compared to \$117,000 for the nine month period ended September 30, 1997, primarily as a result of the inclusion of expenses related to the Company's interest in the Ninotsminda Field subsequent to the Transaction. Direct project costs increased to \$1,012,000 from \$815,000 for the nine month period ended September 30, 1997, reflecting activity related to the Ninotsminda Field subsequent to the Transaction and to BOC and the winding down of certain oil and gas ventures. The increase in depreciation, depletion and amortization expense from \$158,000 for the nine month period ended September 30, 1997 to \$261,000 during the nine month period ended September 30, 1998 is attributable principally to depletion

subsequent to the Transaction related to the Company's acquisition of the Ninotsminda Field and increased production of oil from the Sylvan Lake property. The loss from investments in unconsolidated subsidiaries decreased to \$152,000 during the nine month period ended September 30, 1998, from \$3,011,000 for the

nine month period ended September 30, 1997, as a result of the substantially lower level of activity in the unconsolidated subsidiaries in the first nine months of 1998, reflecting the impairment of most venture assets during 1997. During the nine month period ended September 30, 1998, the Company wrote down its oil and gas properties in the Sylvan Lake project by an aggregate \$900,000 as a result of a substantial decline of heavy oil prices and the application of the quarterly full cost ceiling test. There was no comparable writedown during the first nine months of 1997. If oil prices decline further, the Company may experience additional writedowns.

Although lease operating expenses exceeded revenue for the Sylvan Lake property for the first nine months of 1998, the Company does not believe that such expenses will continue to exceed revenue because expenses during the nine month period ended September 30, 1998 included non-recurring costs. In addition, prices for heavy oil were depressed during the first nine months of 1998, resulting in decreased revenue per unit produced. No assurance can be given, however, that prices for heavy oil will improve or that operating revenue will exceed lease operating expenses from the Sylvan Lake property or other properties in future periods.

The Company recorded net other income of \$171,000 for the nine month period ended September 30, 1998, as compared to \$783,000 during the nine month period ended September 30, 1997. The principal reason for the decrease is the Company's 1998 payment of interest expense on behalf of Kashtan. This was partially offset by a loss that the Company recorded on the disposition of miscellaneous equipment and property amounting to \$266,000 in the first nine months of 1997; the comparable loss incurred in the first nine months of 1998 was \$28,000.

The net loss of \$4,790,000, or \$0.34 per share, during the nine month period ended September 30, 1998 compares to a net loss of \$5,675,000, or \$.51 per share, for the nine month period ended September 30, 1997.

Three month periods ended September 30, 1998 and 1997

The Company recorded operating revenue of \$375,000 during the three month period ended September 30, 1998, compared with \$63,000 for the three month period ended September 30, 1997. Revenue of \$331,000 in the three month period ended September 30, 1998 related to oil production of 151,000 bbls. gross (54,600 bbls. net to NOC) from the Ninotsminda Field subsequent to the Transaction less net production placed in storage of 34,500 bbls. and revenue of \$44,000 related to oil production from the Sylvan Lake property in Alberta, Canada. Revenue for the quarter ended September 30, 1997 primarily related to oil production from the Sylvan Lake property. Net sales from the Ninotsminda Field before prior months oil price adjustments averaged \$11.50 per barrel.

The operating loss for the three month period ended September 30, 1998 amounted to \$787,000, compared with \$2,703,000 for the three month period ended September 30, 1997. Lease operating expenses increased to \$300,000 during the three month period ended September 30, 1998, as compared to \$49,000 for the three month period ended September 30, 1997, primarily as a result of the Company's acquisition of the Ninotsminda Field and as a result of greater unit production from the Sylvan Lake property in the third quarter of 1998. Direct project costs decreased to \$228,000 from \$421,000 for the three month period ended September 30, 1997, primarily reflecting reduced activity with respect to the

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Company's projects that predated the Transaction, partially offset by activity related to the Ninotsminda Field. The increase in depreciation, depletion and amortization expense from \$80,000 for the three month period ended September 30, 1997 to \$101,000 during the three month period ended September 30, 1998 is attributable principally to depletion associated with production of oil from

Ninotsminda Field subsequent to the Transaction, partially offset by a reduced charge for depreciation due to disposal of office equipment. The loss from investments in unconsolidated subsidiaries decreased to \$17,000 during the three month period ended September 30, 1998, as compared to \$1,647,000 for the three month period ended September 30, 1997, as a result of the substantially lower level of activity in the unconsolidated subsidiaries in the third quarter of 1998, reflecting the impairment of most venture assets during 1997.

Although lease operating expenses for the Sylvan Lake property exceeded revenue for the third quarter of 1998, the Company does not believe that such expenses will continue to exceed revenue because expenses during the three month period ended September 30, 1998, included non-recurring costs. In addition, prices for heavy oil were depressed during the third quarter of 1998 resulting in decreased revenue per unit produced due to the decline in heavy oil prices. No assurance can be given, however, that prices for heavy oil will improve or that operating revenue will exceed lease operating expenses from the Sylvan Lake property or other properties in future periods.

The Company recorded net other expense of \$48,000 for the three month period ended September 30, 1998, as compared to net other income of \$346,000 during the three month period ended September 30, 1997. The principal reason for the decrease is the reduced amount of interest earned due to the Company's lower total of cash and cash equivalents and restricted cash in the third quarter of 1998, partially offset by a loss that the Company recorded in 1997 from the disposition of miscellaneous equipment and property amounting to \$44,000 in the third quarter of 1997; there was no comparable loss in the third quarter of 1998.

The net loss of \$781,000, or \$0.04 per share, during the three month period ended September 30, 1998 compares to a net loss of \$2,250,000, or \$.20 per share, for the three month period ended September 30, 1997.

Year Ended December 31, 1997 Compared to Year Ended August 31, 1996

The Company recorded operating revenue of \$313,000 during the year ended December 31, 1997 compared with \$35,000 for the year ended August 31, 1996. Revenue in both years was related to a modest amount of oil and gas production from property in Alberta, Canada in which the Company has interests. The 1997 production was generated primarily at the Sylvan Lake property in which the Company acquired an interest in 1997.

The operating loss for the year ended December 31, 1997 amounted to \$29,090,000, compared with \$5,640,000 for the year ended August 31, 1996. The increase in the operating loss is attributable primarily to the impairment of oil and gas ventures, oil and gas properties, and property and equipment and other assets which aggregated \$19,424,000 in 1997, as well as a \$3,778,000 loss representing the Company's equity in the loss of oil and gas ventures. There were no comparable impairment charges in fiscal 1996, and in that year, the Company's equity in the loss of oil and gas ventures was \$13,000.

Lease operating expenses increased to \$200,000 in 1997, as compared to \$11,000 in fiscal 1996, primarily as a result of the Company's acquisition of an interest in the Sylvan Lake property in early 1997. 1997 direct project costs increased \$485,000 from the \$1,268,000 experienced during the fiscal year ended August 31, 1996, reflecting principally the higher level of project activity and the inability of

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the Company to recoup from Kashtan certain expenses related to the Lelyaki field project incurred during December 1997. General and administrative expenses in the years ended December 31, 1997 and August 31, 1996 were comparable. General and administrative expense are expected to decrease during 1998, at least prior to the consummation of the Transaction. The increase in depreciation and

amortization expense from \$77,000 in the year ended August 31, 1996 to \$345,000 in the year ended December 31, 1997 is attributable principally to the increased production of oil.

During the year ended December 31, 1997, the Company recognized an aggregate of \$19,237,000 in losses as a result of the impairment of long-lived assets, as compared to an impairment loss of \$420,000 for the year ended August 31, 1996. Impairment of the ventures operating the Lelyaki, Maykop and Gorisht-Kocul Field projects resulted in a combined loss of \$15,736,000. The impairment of drilling rigs and related equipment originally intended to be utilized in the Maykop Field project and certain office furniture, fixtures and equipment resulted in a loss of \$3,244,000. The remaining investment in the Rocksprings property, which was carried in the Company's December 31, 1996 balance sheet as a \$257,000 unevaluated oil and gas property was recognized as impaired in 1997. The remaining assets impaired during 1997 were notes receivable from the entity that sold to the Company its principal interest in Kashtan, as to which there were doubts regarding collectability.

In 1997, the Company recorded total other income of \$1,202,000, as compared to total other expense of \$854,000 in the year ended August 31, 1996. Interest income increased to \$1,615,000 for the year ended December 31, 1997 from \$332,000 for the year ended August 31, 1996 due to higher average cash and cash equivalent investments. Interest expense decreased from \$1,016,000 for the year ended August 31, 1996, when the Company recorded amortization of financing costs, discount and interest related to the Company's 8% Convertible Subordinated Debentures, to \$69,000 for calendar 1997. In both 1997 and fiscal 1996, the Company recorded losses from the sale of miscellaneous equipment and property amounting to \$271,000 and \$182,000, respectively.

The net loss of \$27,683,000, or \$2.47 per share, in 1997 compares to a net loss of \$6,494,000, or \$1.04 per share, in the fiscal year ended August 31, 1996. The disproportionate losses per share are attributable to the Company's issuance of additional shares subsequent to August 31, 1996, resulting in a substantially higher weighted average number of common shares outstanding during the year ended December 31, 1997.

Four Months Ended December 31, 1996 Compared With Four Months Ended December 31, 1995

The Company recorded an operating loss of \$2,983,000 during the four month period ended December 31, 1996 compared with \$1,470,000 for the same 1995 period. The increased loss resulted from an increase of approximately \$1,357,000 of equity loss from investments in unconsolidated subsidiaries primarily associated with the activities of the oil and gas ventures in Eastern Europe in which the Company has interests.

General and administrative expenses for the four month period ended December 31, 1996 amounted to \$1,282,000 reflecting a modest decrease from the \$1,303,000 for the comparable 1995 period. For the 1995 period, general and administrative costs included a charge for external services for public relations activities of a non-recurring nature. The decrease in the 1996 period for such expense was substantially offset by increases in salaries and other administrative costs related to the build-up of staff associated with the projects in Eastern Europe. General and administrative expense is net of

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\$1,220,000 and \$320,000 capitalized pursuant to full cost accounting rules during the four month period ended December 31, 1996 and 1995, respectively.

Interest income increased to \$424,000 for the four month period ended December 31, 1996 from \$55,000 in the comparable period for the prior year due to higher average cash investments. Interest expense increased to \$13,000 for the four month period ended December 31, 1996 from \$3,000 in the comparable

period for the prior year due to the amortization of financing costs and interest related to the Company's Debentures and financing of insurance premiums.

Twelve Months Ended August 31, 1996 Compared With Twelve Months Ended August 31, 1995

The Company recorded operating revenue of \$35,000 during the year ended August 31, 1996 compared with \$625,000 for the year ended August 31, 1995. The decrease in revenue resulted from a decline in sale of EEOR equipment. The Company decided not to market the EEOR technology to third parties but rather to use the technology primarily as a competitive advantage to secure new heavy oil interests and, assuming successful commercialization, to optimize production and reserves from such interests. Consequently while all \$625,000 of 1995 revenue related to EEOR technology, only \$9,000 of 1996 revenue was associated with the EEOR technology. Most 1996 revenue was related to a modest amount of oil and gas production from an overriding royalty interest held by the Company relating to property in Alberta, Canada.

The operating loss for the year ended August 31, 1996 amounted to \$5,640,000 compared with \$7,883,000 for the year ended August 31, 1995. The reduction in the operating loss was attributable primarily to non-recurring 1995 expense items relating to the impairment of patent rights and certain other assets written off at the end of fiscal 1995, the amortization of those patent rights during 1995, and 1995 financial public relations expenses paid primarily by the issuance of the Company Common Stock, partially offset by higher 1996 direct project costs of \$1,268,000 and general and administrative expense (other than those related to financial public relations) associated with the development of an organization and infrastructure for the Company's oil and gas activities.

General and administrative expenses for the year ended August 31, 1996 amounted to \$3,854,000 compared to \$4,013,000 for the year ended August 31, 1995. For the 1995 period, general and administrative costs included a substantial charge for external services fees for financial public relations activities of a non-recurring nature. The decrease in the 1996 financial public relations expense was substantially offset by increases in salaries and other administrative costs related to the build-up of staff associated with the projects in Eastern Europe.

Depreciation, depletion, and amortization expense decreased from \$1,157,000 in fiscal 1995, to \$77,000 for fiscal 1996. This reduction was attributable primarily to the recognition at August 31, 1995 of the impairment of intangible assets on which amortization had been charged at the rate of approximately \$223,000 per quarter during fiscal 1995.

During fiscal 1996, the Company recognized an impairment of \$420,000 on its oil and gas properties as a result of applying the full cost ceiling limitation. Of this amount, \$269,000 related to the Company's investment in the Rocksprings project in West Texas. As of August 31, 1996, the Rocksprings field had only produced insignificant amounts of gas from one of the two wells in which the Company participated. During fiscal year 1995, the Company recognized \$608,000 of impairment expense on the same project. As of August 31, 1996, the Company had a \$257,000 unevaluated oil and

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gas property on its balance sheet related to the Rocksprings project. The remaining 1996 expense associated with impairment of oil and gas properties related to the Company's 50% working interest in the West Mexia field, which involved a now abandoned experimental well to test new technology for determining the remaining predictable oil between wells and in wells that had become early water producers.

During 1996, the Company recorded a loss of \$182,000 from the sale of certain drilling equipment. Interest income increased to \$332,000 for the year ended August 31, 1996 from \$251,000 in the prior year due to higher average cash investments. Interest expense increased to \$1,016,000 for the year ended August 31, 1996 from \$28,000 in the prior year due to the amortization of financing costs, discount and interest related to the Company's Debentures.

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BUSINESS

GENERAL DEVELOPMENT OF CANARGO'S BUSINESS

CanArgo Energy Corporation ("CanArgo") was formed in 1994 to continue, through reincorporation in Delaware, the business of a predecessor Oklahoma corporation which was formed in 1980. CanArgo changed its name from Fountain Oil Incorporated to CanArgo Energy Corporation in connection with a business combination with CanArgo Oil & Gas Inc. completed on July 15, 1998. The Company conducts its principal operations through subsidiaries, and unless otherwise indicated, the term the "Company" refers to CanArgo Energy Corporation and its consolidated subsidiaries.

The Company initially operated as an oil and gas exploration and production company. It altered its principal focus to the application of electrically enhanced heavy oil recovery technology in 1988, and that focus continued through 1994. In early 1995, the Company shifted its principal activities to acquiring and developing interests in Eastern European oil and gas properties. From 1995 to 1997, the Company established significant ownership interests in four Eastern European oil and gas development projects. As a result of disappointing results and other negative indications, the Company during the fourth quarter of 1997 wrote-off its entire investments in three of those four projects and began actively to seek a business combination or similar transaction with another oil and gas company.

As a result of this effort, the Company entered into a business combination with CanArgo Oil & Gas Inc. Upon completion of the business combination in July 1998, CanArgo Oil & Gas Inc. became a subsidiary of the Company, the management of CanArgo Oil & Gas Inc. assumed the senior management positions in the Company, and the Company changed its name to CanArgo Energy Corporation.

At the time of the business combination, the principal operations and assets of CanArgo Oil & Gas Inc. were associated with the producing Ninotsminda oil field in the Republic of Georgia. Since the combination, development of the Ninotsminda field and related activities have become the Company's main focus. The Company has additional exploratory and developmental oil and gas properties and prospects in Georgia and Ukraine, owns interests in other Eastern European oil and gas projects which the Company is not actively pursuing, and holds interests in small oil and gas properties in North America, some of which are producing modest amounts of oil and gas. The Company's principal product is crude oil, and the sale of that oil is its principal source of revenue.

NINOTSMINDA OIL FIELD

Since completion of the business combination with CanArgo Oil & Gas Inc., the Company's resources have been focused on the development of the Ninotsminda oil field and some associated activities. The Ninotsminda oil field covers some 2,500 acres and is located forty kilometers east of the Georgian capital, Tbilisi. It is adjacent to and west of the Samgori oil field, which is Georgia's most productive oil field. Ninotsminda was discovered later than Samgori and has experienced substantially less development activity. The state oil company, Georgian Oil, and others including the Company have drilled sixteen

wells in the Ninotsminda field, of which seven are currently classified as producing. Three of the seven "producing" wells are presently shut-in awaiting completion of work-over operations, and the remaining four wells are currently producing approximately 1,200 barrels of oil per day.

Business Structure

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The Company's activities at the Ninotsminda oil field are conducted through Ninotsminda Oil Company ("NOC"), a 68.5% owned subsidiary. In November 1998, the Company increased its percentage ownership of NOC from 55.9% to 68.5% when the other shareholder of NOC chose not to subscribe for its pro rata portion of shares being offered to increase the capital of NOC. During 1998, the Company invested \$6,394,000 of cash in NOC and, in addition, capitalized an aggregate of \$1,164,000 in loans and accrued interest. If the other shareholder of NOC continues to decline to provide its pro rata share of NOC's required capital, the Company may be required to provide a disproportionate share of the capital NOC requires, which would result in an increase in the Company's percentage ownership of NOC.

NOC obtained its rights to the Ninotsminda field and two other fields under a 1996 production sharing contract with Georgian Oil and an associated license. NOC's rights under the agreement and license expire in December 2019, subject to possible loss of undeveloped areas prior to that date and possible extension with regard to developed areas.

Under the production sharing contract, Georgian Oil has a priority right to receive approximately 542 barrels of oil per day during 1999, 280 barrels of oil per day during 2000 and 93 barrels of oil per day during 2001, representing a projection of what the Ninotsminda field would have yielded during those years based upon the wells and equipment in use at the time the contract was entered into. Of the remaining production, up to 50% will be allocated to NOC for the recovery of the cumulative capital and operating costs associated with the Ninotsminda field, which NOC initially pays. The balance of production is allocated on a 70/30 basis between Georgian Oil and NOC. Thus while NOC continues to have unrecovered costs, it will receive 65% (50% plus 30% of the other 50%) of production in excess of the oil allocated to Georgian Oil on a priority basis with respect to projected base production. The allocation of a share of production to Georgian Oil relieves NOC of all obligations it would otherwise have to pay taxes and similar levies to the Republic of Georgia.

Both Georgian Oil and NOC take their shares of production in kind, and they market their oil separately.

Pursuant to the terms of the production sharing contract, a local, Georgian company must be appointed as field operator. The field operator provides the operating personnel and is responsible for day-to-day operations. NOC pays the operating company's expenses associated with the development of the Ninotsminda field, and the operating company performs on a non-profit basis. The governing body for Ninotsminda field operations consists of members designated by Georgian Oil and NOC, with the deciding vote allocated to NOC. The company serving as Ninotsminda field operator has eighty-eight full time employees, and substantially all of its activities relate to the development of the Ninotsminda field.

Field Development

When NOC assumed developmental responsibility for the Ninotsminda field in 1996, production was minimal. The Company believes that the development and productivity of the Ninotsminda field had in the past been hampered by, among other factors, a lack of funding, civil strife and utilization of non-optimal technology.

NOC's initial approach to Ninotsminda field development involved

reworking and adding additional perforations to existing wells, and this program is continuing. In 1997, NOC commenced a drilling program, which has involved three wells thus far. The first was completed in October 1997.

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Under normal production conditions, this well has been producing at the rate of 400 to 600 barrels per day. The second well was completed in October 1998. While testing and stimulation of this well are continuing prior to NOC placing the well on production, the Company believes that the second well will be less productive than the first. The drilling of the third well was suspended in December 1998 at a depth of 700 meters as a result of undependable electrical supply and is expected to resume in the spring of 1999 when the electrical supply is expected to improve. The lack of a reliable power supply has also caused delays in the testing of the second well and in the continuing field workover program. NOC expects that the electrical supply problem will be resolved or mitigated if and when a planned gas fired, electric generating power plant near Ninotsminda commences operations. See "-- Ancillary Projects - - Electrical Power Generation."

During 1997 and 1998, NOC acquired additional seismic data about the Ninotsminda field, which the Company believes will be useful in selecting additional drilling sites. To date, exploration and production at the Ninotsminda field have focused on one zone. There is, however, a second zone, from which oil has been produced in one well, that NOC intends to examine. In addition, the Ninotsminda field has a gas cap above the principal producing zone. The Company has not yet considered the reserves and economics of production relating to the gas cap, since significant production at this time could be prejudicial to oil recovery, but may consider them in the future.

NOC's current development program contemplates the commencement of at least three additional wells, the workover of various existing wells, and the installation of additional facilities designed to increase production to at least 4,500 barrels of oil per day.

International Finance Corporation Loan

In December 1998, NOC entered into a convertible loan agreement with International Finance Corporation ("IFC"), an affiliate of the World Bank. Disbursement of the loan is subject to a number of conditions, including the Company providing or arranging for a \$2,000,000 subordinated loan to NOC. The IFC loan is to be used to implement NOC's current Ninotsminda field development program. The loan will bear interest at LIBOR (currently approximately 5%) plus 3% and will be repayable in five semi-annual payments of \$1,200,000 each commencing December 2001. NOC paid to IFC a facility fee of \$60,000 and will pay a commitment fee equal to 1/2 of 1% per annum on the portion of the \$6,000,000 that has not been disbursed. The first disbursement under the loan agreement must be made before July 1, 1999, and IFC has no obligation to disburse funds after June 29, 2000.

The Company does not presently have the resources to provide the \$2,000,000 subordinated loan to NOC, and a high priority use of the proceeds of this offering is funding that subordinated loan.

The IFC has the right under the loan agreement to convert all or part of the loan into common shares of NOC. If the entire \$6,000,000 loan were converted, IFC would receive shares representing 20% of the equity of NOC. This would reduce the Company's percentage ownership of NOC from 68.5% to 54.8% but would leave NOC as a consolidated subsidiary of the Company. The conversion right remains in effect until three months after the successful completion of NOC's current development program or the achievement of sustained production of at least 4,500 barrels of oil per day and, in either case, the completion of various procedural requirements.

Both the Company and the other shareholder of NOC have guaranteed the IFC loan in proportion to their holdings of NOC stock and have pledged that stock to IFC to secure their guaranty obligations.

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NOC has pledged substantially all of its assets to IFC to secure the loan. In the event IFC converts the loan into NOC stock, it may require the Company to repurchase those shares at prices based upon the greater of (i) the cost of the shares to IFC plus interest and (ii) the NOC net asset value attributable to the shares. The repurchase obligation will terminate no later than December 31, 2007.

Processing, Sale and Customers

Georgian Oil built a considerable amount of infrastructure in and adjacent to the Ninotsminda field prior to entering into the production sharing contract with NOC, and those infrastructure improvements are now used by NOC.

The mixed oil and water fluid produced from the Ninotsminda field wells flows into a two-phase separator located at the Ninotsminda field, where gas associated with the oil is separated. The oil and water mixture is then transported eleven kilometers in a pipeline to Georgian Oil's central processing facility at Sartichala for further treatment. The gas is transported to Sartichala in a separate pipeline where some is used for fuel and the rest is currently flared.

At Sartichala, the water is separated from the oil. NOC then sells oil in this state to buyers at Sartichala, and the buyers at that point assume responsibility for the oil. The buyers generally transport the oil at their risk and cost by pipeline 20 kilometers to a railhead at Ghaciani. At the railhead, the oil is loaded into railcars for transport directly to the buyers' customers or to the Black Sea port of Batumi, Georgia, where oil can be loaded onto tankers for international shipment.

NOC sells its oil directly to local and international buyers. NOC sold all of its 1997 production to one buyer, Glencore International AG. In 1998, NOC sold its production to three customers as follows:

<TABLE>
<CAPTION>

| Customer ----- | Percent of Production ----- |
|---------------------------|--------------------------------|
| <S> | <C> |
| Sis Plus 7 Ltd. | 35.9% |
| Glencore International AG | 34.4 |
| Navtobi Ltd. | 29.7 |

</TABLE>

The price received for oil by NOC has generally been negotiated on the basis of the European spot price for Brent grade crude oil, less certain discounts for transportation and related charges. The price received by NOC has ranged from the full Brent price to Brent minus \$5.83 per barrel. The average discount from Brent prices was less in 1998 than 1997, as buyers have begun to purchase oil from NOC for use in Georgia and neighboring countries and have accordingly faced smaller transportation costs. NOC now maintains an inventory of oil available for local buyers principally on cash payment terms. The average discount from the spot price for Brent grade crude oil is approximately \$1.50 at the present time.

CanArgo believes that the loss of a current customer would not result in any significant delay in sale of its production, but could result in

lower selling prices. At current spot prices for Brent grade crude oil, a discount for transportation and related charges that is substantially greater than \$1.50 per barrel could render the production and sale of Ninotsminda field oil uneconomic.

At current world oil prices, NOC's revenues from the sale of its share of oil production under the production sharing contract are insufficient to cover production and depletion expenses. In order to cover

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production and depletion expenses under the production sharing contract at the current production level of approximately 1,200 barrels per day, the price for Brent crude oil would need to be approximately \$11.50 per barrel. The European spot price for Brent crude oil on February 5, 1999 was \$10.18 per barrel. See "RISK FACTORS --Oil and gas prices are volatile."

Production History

The Ninotsminda field was discovered and initial development began in 1979. Ninotsminda field is currently producing approximately 1,200 barrels per day of oil plus associated gas primarily from four wells. Gross production from the Ninotsminda field for the past three years was as follows:

<TABLE>

<CAPTION>

| Year ended December 31, ----- | Oil (Gross Barrels) ----- |
|----------------------------------|------------------------------|
| <S> | <C> |
| 1998 | 600,000 |
| 1997 | 639,910 |
| 1996 | 515,000 |

</TABLE>

Productive Wells and Acreage

The following table summarizes the number of productive oil wells and the total developed acreage for the Ninotsminda field. Such information has been presented on a gross basis, representing the interest of NOC, and on a net basis, representing the interest of the Company based on its 68.5% interest in NOC. The information is presented as at December 31, 1998.

<TABLE>

<CAPTION>

| | Gross ----- | | Net ----- | |
|-----------------------|--------------------------|------------------|--------------------------|------------------|
| | Number of Wells ----- | Acreage ----- | Number of Wells ----- | Acreage ----- |
| <S> | <C> | <C> | <C> | <C> |
| Ninotsminda field (1) | 6 | 2,500 | 4.1 | 1,713 |

</TABLE>

(1) On December 31, 1998, there were no productive wells or developed acreage on any of the Company's other Georgian properties, except for one well on the West Rustavi field which was shut-in at that date.

Reserves

The following table summarizes net hydrocarbon reserves for the

Ninotsminda oil field, which are the only significant reserves for the Company. This information is derived from a report as of December 31, 1998 prepared by AMH Group Ltd. ("AMH"), independent petroleum consultants. This report is available for inspection at the Company's executive offices during regular business hours.

Considerable uncertainty exists in the interpretation and extrapolation of existing data for the purposes of projecting the ultimate recovery of oil from underground reservoirs and of the corresponding economic return. No assurance is given that the projections included in the report by AMH will be

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realized. The evaluation by AMH represents the efforts of AMH to predict the performance of the oil recovery project using their expertise and the available data at the effective date of their report. See "RISK FACTORS -- Reserve information is uncertain."

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<TABLE>

<CAPTION>

| | OIL RESERVES | | PSC Entitlement Volumes (1) | |
|--------------------------------|--------------------------|---------|-----------------------------|----------------------------------|
| | Gross | Net (2) | NOC Entitlement | Company Share of NOC Entitlement |
| | ----- | ----- | ----- | ----- |
| | (In Millions of Barrels) | | | |
| <S> | <C> | <C> | <C> | <C> |
| Proved Developed Producing | 2,404 | 1,647 | 1,340 | 918 |
| Proved Developed Non-Producing | 1,379 | 945 | 890 | 610 |
| Proved Undeveloped | 15,200 | 10,412 | 8,783 | 6,016 |
| | ===== | | ===== | ===== |
| TOTAL PROVEN | 18,983 | 13,004 | 11,013 | 7,544 |

</TABLE>

- - - - -

- (1) PSC (production sharing contract) Entitlement Volumes are those produced volumes which, through the production sharing contract, accrue to the benefit of NOC and, as a result of the Company's interest in NOC, accrue to the benefit of the Company for the recovery of capital, repayment of operating costs and share of profit.
- (2) Net Oil Reserves represent the Company's 68.5% share of NOC's interest under the production sharing contract in the gross reserves, before taking into account the interest of Georgian Oil.

"Proved reserves" are those reserves estimated as recoverable under current technology and existing economic conditions from that portion of a reservoir which can be reasonably evaluated as economically productive on the basis of analysis of drilling, geological, geophysical and engineering data, including the reserves to be obtained by enhanced recovery processes demonstrated to be economically and technically successful in the subject reservoir. "Proved reserves" includes "proved producing reserves", "proved non-producing reserves" and "proved undeveloped reserves".

"Proved Producing Reserves" are those proved reserves that are actually on production or, if not producing, that could be recovered from existing wells or facilities and where the reasons for the current non-producing status is the choice of the owner rather than the lack of markets or some other reason. An illustration of such a situation is where a well or zone is capable but is shut-in because its deliverability is not required to meet commitments. 1998 production was 554,663 barrels.

"Proved non-producing reserves" have been calculated based on the following parameters. Due to the general workover program delays, several wells were shut-in or remained shut-in during 1998. These non-producing reserves are expected to be recovered from producing zones in existing well bores open at the time of the reserve estimate, but production is not occurring for mechanical reasons or the lack of maintenance type workovers. Although these reserves are currently not producing, they are expected to be producing in the short term.

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"Proved undeveloped reserves" are proven reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where relatively major expenditures are required for the completion of these wells or for installation of processing and gathering facilities prior to the production of these reserves. Reserves on undrilled acreage are limited to those drilling units offsetting productive wells that are reasonably certain of production when drilled.

Other Fields and Prospects Under 1996 Production Sharing Contract

NOC has rights to one other field, West Rustavi, and one prospect, Manavi, in addition to the Ninotsminda field, under the 1996 production sharing contract.

The West Rustavi field is located some 40 km southeast of Ninotsminda. Ten wells were drilled by Georgian Oil in the West Rustavi field, two of which produced oil. NOC has initiated an appraisal program and commenced test production from one of the wells. The appraisal program, which includes acquiring further seismic data and performing workovers on some of the wells, is aimed at assessing Georgian Oil's original reserve estimates and ultimately initiating an appropriate development program.

The Manavi prospect is located east of Ninotsminda. NOC has seismic data regarding the Manavi prospect from both work NOC commissioned and earlier efforts by Georgian Oil. Georgian Oil's attempt to drill in the Manavi prospect was thwarted by logistical problems and did not reach the reservoir. The Company's management ranks it highly as an exploration prospect.

Ancillary Projects

Electrical Power Generation

The Company has an effective 42.5% interest in a Georgian stock company that intends to produce electricity. This company is planning to install and operate a pilot 3.0 megawatt gas fired power plant to be located adjacent to the Ninotsminda field. The plant would utilize gas from the Ninotsminda field as fuel and would sell the electricity generated to NOC for the Ninotsminda field project and to other local purchasers. The basic equipment, a refurbished Rolls Royce Proteus single cycle gas turbine with attached Siemens electrical generating equipment, is expected to be in Georgia and operational during the second quarter of 1999.

Once operational, this project would be one of the first private sector power producers in Georgia. Privatization of the Georgian power sector is well underway. The 1997 Electricity Law restructured the power sector to facilitate competition, mandated unbundling of the generation, transmission and

distribution functions, increased tariffs substantially and established an independent regulatory commission to grant licenses and regulate tariffs.

NOC expects that the private power company will supply electricity for Ninotsminda field operations on a priority basis. If this happens, NOC should be able to avoid or mitigate the electrical supply problems it has encountered, which forced a suspension of drilling activity on the third well and interfered with other operations.

The Company is actively seeking to expand its involvement in the Georgian power sector and is seeking to attract financial partners to join it in pursuing opportunities for private sector power production in Georgia.

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Refinery

In September 1998, the Company signed an agreement to purchase up to 24% of the equity in a company which owns a small refinery located at Sartichala, Georgia. Thus far, the Company has purchased a 12.9% interest for \$1,000,000, with the proceeds being used to upgrade and expand the refinery. The Company retains the right to purchase the remaining 11.1% interest at the same rate.

The refinery, which utilizes primarily refurbished American equipment, began operations in July 1998 and has a current capacity of approximately 2,000 barrels per day. It is the only refinery in Georgia employing western technology. It is able to produce naphtha, diesel fuel, fuel oil, kerosene and jet fuel. Refinery expansion plans envision capacity of over 4,000 barrels per day, with further capacity expansion and product extension possible in the future.

Sartichala is the primary processing center for east Georgian oil production, including production from Ninotsminda. Refined products are sold on both the local and export markets. Although the refinery receives some revenue from the sale of its products in the Georgian currency, the Lari, most pricing is related to dollar based world market prices. To mitigate the currency exchange risk, the refinery has established some export sales contracts denominated in United States dollars. The Company believes that its involvement in Georgian refining activity strengthens its position in the Georgian energy sector and provides specific support for NOC's activities in Ninotsminda.

OTHER EASTERN EUROPEAN PROJECTS

Nazvrevi / Block XIII

In February 1998, the Company entered into a second production sharing contract with Georgian Oil. This contract covers the Nazvrevi and Block XIII areas of East Georgia, a 2,100 square kilometer exploration area adjacent to the Ninotsminda and West Rustavi fields and containing existing infrastructure. The agreement extends for twenty-five years, but portions of the area not being actively pursued are relinquished at five year intervals. The Company commissioned seismic studies of the exploration area, and the results of those studies are currently being interpreted, with a view towards defining possible oil and gas prospects and exploration drilling locations.

Under the production sharing contract, the Company pays all operating and capital costs. The Company first recovers its cumulative operating costs from production. After deducting production attributable to operating costs, 50% of the remaining production, considered on an annual basis, is applied to reimburse the Company for its cumulative capital costs. While cumulative capital costs remain unrecovered, the other 50% of remaining production is allocated on a 50/50 basis between Georgian Oil and the Company. After all cumulative capital costs have been recovered by the Company, remaining production after deduction of operating costs is allocated on a 70/30 basis between Georgian Oil and the

Company. The allocation of a share of production to Georgian Oil relieves the Company of all obligations it would otherwise have to pay the Republic of Georgia for taxes and similar levies related to activities covered by the production sharing contract. Both Georgian Oil and the Company will take their respective shares of production under this production sharing contract in kind.

In October 1998, XCL Ltd., a Louisiana based oil exploration company, agreed to purchase shares representing 11.5% of the outstanding equity of the Company's subsidiary holding the Nazvrevi-Block XIII production sharing contract, for \$650,000. The proceeds will be applied by the subsidiary to

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fund a portion of the seismic acquisition, processing and interpretation program relating to the Nazvrevi and Block XIII areas. The total seismic program is expected to cost approximately \$1,150,000, a portion of which the Company expects to fund from working capital, including that supplied by the proceeds of this offering. After completion of the seismic program, the Company will not face another milestone under the work requirements of the production sharing contract until February 2001.

Stynawske Field, Western Region, Ukraine

In November 1996, the Company entered into a joint venture arrangement with the Ukrainian state oil company, Ukranafta, for the development of the 6,000 acre Stynawske field, located in Western Ukraine near the town of Stryv. The Company has a 45% interest in the joint venture, with Ukranafta holding the remaining 55% interest. Ukranafta retains rights to base production, representing a projection of what the Stynawske field would produce in the future, based on the physical plant and technical processes in use at the time of license grant, on a declining basis through 2001. The joint venture will be entitled to all incremental production above that declining base.

The Stynawske field is a relatively tight sandstone reservoir containing light sweet oil. The production from the field commenced in 1967 but was substantially terminated after a few years of production due to environmental considerations. The field is located underneath the main water supply for Western Ukraine, and leakage from producing wells some 20 years ago threatened to pollute this aquifer. Four wells that are located away from the water supply have been allowed to continue production.

In preparation for the commencement of development activities, the joint venture has carried out an environmental audit of the Stynawske field, the technical and economic evaluation of the project and the selection of drilling sites. The Company expects that the initial phase will consist of the workover of a number of existing wells, with a view towards increasing production and gathering data for the preparation of a full field development program. The feasibility of the initial phase is currently being considered, including financing and ultimate recovery of funds invested.

The Company has concluded on a preliminary basis that the full field development plan for the rehabilitation of the Stynawske field will probably be based on deviated drilling, in which the drilling sites for the wells would be located a safe distance from the water supply and the wells would enter the reservoir at angles avoiding the aquifer. Additional measures would be taken with the drilling mud and otherwise to protect the environmental integrity of the project. Reservoir pressure support through gas or water injection may be necessary to optimize recovery. The full field development plan for the Stynawske field will, however, depend upon data developed during an initial workover phase.

The Company is actively seeking to establish arrangements under which oil and gas production companies or other investors would acquire a portion of the Company's interest in the joint venture in return for supplying financing or

services to implement the initial phase of the project. If the Company does not proceed with a development program, it may be in breach of obligations it has with regard to the joint venture. This could place the Company's rights to the Stynawske field at risk and could subject the Company to possible liability. See "-- Legal Proceedings."

Potential Caspian Exploration Project

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In May 1998, the Company led a consortium which submitted a bid in a tender for two large exploration blocks in the Caspian Sea, located off the shore of the autonomous Russian republic of Dagestan. The consortium was the successful bidder in the tender and was awarded the right to negotiate licenses for the blocks. Following negotiations, licenses were issued in February 1999 to a majority-owned subsidiary of CanArgo. The licenses impose substantial commitments on the licensee and the Company is assessing its options for meeting such commitments in light of the Company's limited resources and existing commitments. If the Company determines that it cannot assume the commitments, the Company will relinquish its rights under the licenses.

Previously Impaired Projects

Gorisht-Kocul Field, Albania

The Company and the Albanian state oil company, Albpetrol, formed a 50/50 joint venture to rehabilitate and develop the Gorisht-Kocul field. The Albanian government granted the joint venture a 25 year production license covering approximately 16.5 square kilometers constituting the Gorisht-Kocul field. Production at the Gorisht-Kocul field commenced in 1966. The field, which contains relatively heavy oil, has reportedly produced approximately 69 million barrels to date. The Company was named operator of the Gorisht-Kocul field with responsibility for implementing the development plan and arranging financing for the project.

In March 1997, the Company declared the political unrest in Albania to be a force majeure, and the joint venture suspended activities. The suspension continues. In light of the extended period that the force majeure condition continued and the absence of any indication of an imminent termination of the condition, the Company recorded during the fourth quarter of 1997 an impairment for the entire amount of its investment in and advances to the Albanian joint venture. Albpetrol has requested that the joint venture recommence activities at the Gorisht-Kocul field, and the Company is evaluating that request and seeking others who may want to participate in this project. If it is unsuccessful in attracting others to participate in this project, the Company may relinquish this project.

Lelyaki Field, Pryluky Region. Ukraine

The Company holds an effective 45% interest in a joint venture company formed to develop the Lelyaki Field in eastern Ukraine. The Company's partner in this joint venture is Ukranafta, which holds a 55% interest. The joint venture received a 20 year oil and gas production license for a 67 square kilometer portion of the Lelyaki Field, as well as a five year exploration license for 327 square kilometer area surrounding the production area.

Based on its analysis of initial development efforts including consulting with independent petroleum engineers, the Company concluded that the Lelyaki Field would not support a successful commercial development. On the basis of that conclusion, the Company recorded during the fourth quarter of 1997 an impairment for the entire amount of its remaining investment in and advances to the Lelyaki joint venture and advised the joint venture that the Company would not provide it with any further financial support. The joint venture continues to produce a modest amount of oil from wells recompleted by the joint

venture, which is sold in the Ukrainian market.

Maykop Field, Adygea

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The Company holds a 37% interest in Intergas, a Russian joint stock company with a license for the Maykop gas field. In 1994, Intergas was granted an exclusive 25 year exploration and production license covering specified zones in the 12,500 acre Maykop gas condensate field in the southern Russian autonomous republic of Adygea, located approximately 185 kilometers from the Black Sea. In 1996 through 1997, the Company experienced delays and difficulty in resolving operating arrangements and other matters relating to Intergas. This caused the Company to conclude that it could not effectively pursue commercial activities and develop the Maykop field as planned. As a result, the Company recorded during the fourth quarter of 1997 an impairment for the entire amount of its investment in and advances to Intergas. The Company is currently in discussions with the other shareholders regarding the future of Intergas. The Company believes that it has no further obligation to fund any operations of Intergas, but Intergas may assert claims against the Company. See "-- Legal Proceedings".

RISKS ASSOCIATED WITH THE COMPANY'S OIL AND GAS ACTIVITIES

All oil and gas development and production activities are subject to risks and uncertainties inherent in the oil and gas industry. These industry related risks and uncertainties are discussed under "RISK FACTORS --The Company's oil and gas activities involve many risks." Projects in Eastern Europe are subject to certain additional specific risks. These additional specific risks are discussed under "RISK FACTORS -- The Company's foreign operations are subject to special risks. "

The consolidated financial statements of the Company do not give effect to any further impairment in the value of the Company's investment in oil and gas ventures and properties or other adjustments that would be necessary if financing cannot be arranged for the development of such ventures and properties or if such ventures and properties are unable to achieve profitable operations. The Company's consolidated financial statements have been prepared under the assumption of a going concern. Failure to arrange such financing on reasonable terms or failure of such ventures and properties to achieve profitability would have a material adverse effect on the results of operations, financial condition including realization of assets, cash flows and prospects of the Company and ultimately in its ability to continue as a going concern. See "RISK FACTORS -- The Company has incurred substantial losses and has minimal revenues."

The Company has made advances and may make additional advances to its Eastern European oil and gas ventures for capital and operating expenditures. Advances are generally recoverable only from future production or revenue of the ventures. No assurance can be given that future production or revenue will be adequate to recover any such advances.

NORTH AMERICAN OIL AND GAS PROPERTIES AND VENTURES

The Company has interests in several small oil and gas properties located in Alberta, Canada and Texas. These properties either are non-producing or are producing insignificant amounts of oil and gas.

COMPETITION

The oil and gas industry is highly competitive. The Company encounters competition from other oil and gas companies in all of its operations, including the acquisition of producing properties, obtaining scarce resources and services including oil field services, and the sale of crude oil. The Company's competitors include integrated oil and natural gas companies and

numerous independent oil and gas companies, individuals and drilling and income programs. Many of these competitors are large,

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well-established companies with substantially larger operating staffs and greater capital resources than the Company and which, in many instances, have been engaged in the energy business for a much longer time than the Company. Such competitors may be able to develop better information and provide better analysis of available information, to pay more for productive oil and natural gas properties and exploratory prospects and to define, evaluate, bid for and purchase a greater number of properties and prospects than the Company's financial or human resources permit.

In the competition to acquire oil and gas properties, the Company has relied substantially on the relationships its officers and directors have developed in the international oil and gas industry and in its areas of operation and interest. As a result of the termination of employment of various former officers, the Company's ability to benefit from such relationships in certain areas has been significantly reduced. The Company's management believes that the Company's relatively small size has enabled it to consider projects that would be deemed to be too small for consideration by many larger competitors. See "RISK FACTORS -- The Company encounters intense competition."

TECHNOLOGY FOR ENHANCED RECOVERY OF HEAVY OIL

The Company has rights to a technology based upon heating heavy oil in the reservoir with electric current. Heavy oil is very viscous at reservoir temperatures and normally needs to be heated in order to flow easily. Several pilot projects involving the technology have been implemented during the past ten years, and while results have varied, the Company believes that they suggest the validity of the technology. The Company, however, has not successfully commercialized this technology, and during the past several years the Company has not devoted any significant resources to the development or commercialization of this technology. The Company has no plans to devote significant resources to this technology in the foreseeable future.

GOVERNMENTAL AUTHORIZATIONS

The Company's business in Eastern Europe operates pursuant to licenses, concession agreements or other authorizations granted by the local governmental authorities. These authorizations impose various requirements upon the Company, either directly or indirectly. The failure to satisfy the requirements of any authorization could result in its termination or cancellation. In addition, as sovereign agencies, the governmental authorities that have granted authorizations may have greater power than private parties to terminate such authorizations arbitrarily. Loss of such authorizations could have a material adverse effect upon the financial condition, results of operations, cash flows and prospects of the Company.

ENVIRONMENTAL MATTERS

The development of oil and gas fields and the production of hydrocarbons inherently involve environmental risks. These risks can be minimized, but not eliminated, through use of various engineering and other technological methods, and the Company intends to employ such methods to industry standards. The potential environmental problems are enhanced when the oil and gas development and production activities involve the rehabilitation of fields where the practices and technologies employed in the past have not embodied the highest standards then in effect, which has been the case in the Eastern European oil fields in which the Company has commenced operations. See "RISK FACTORS -- The Company's oil and gas activities involve many risks. "

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The Company's business is subject to certain national, provincial, state and local laws and regulations relating to the exploration for and the development, production and transportation of oil and natural gas, as well as environmental and safety matters. Many of these laws and regulations have become more stringent in recent years, imposing greater liability on a larger number of potentially responsible parties. The Company believes it has complied in all material respects with these laws and regulations. Because the requirements imposed by such laws and regulations are frequently changed, the Company is unable to predict the ultimate cost of compliance with these requirements or their effect on its operations. See "RISK FACTORS -- Oil and gas operations are subject to extensive regulation."

EMPLOYEES

As of February 1, 1999, the Company had 12 full time employees. The company acting as operator of the Ninotsminda oil field for NOC has 88 full time employees, and substantially all of that company's activities relate to the development of the Ninotsminda field.

PROPERTIES

The Company does not have outright ownership of any real property. Its real property interests are limited to leasehold and mineral interests.

The following table summarizes the gross and net undeveloped acreage held under the Ninotsminda and Nazvrevi/Block XIII production sharing contracts on December 31, 1998. The information regarding gross acreage represents the interest of NOC under the Ninotsminda contract and the interest of a majority-owned subsidiary of the Company under the Nazvrevi/Block XIII contract. The information regarding net acreage represents the interest of the Company based on its 68.5% interest in NOC and its anticipated 88.5% interest in the subsidiary holding the Nazvrevi/Block XIII contract.

<TABLE>

<CAPTION>

| | Gross Acreage | Net Acreage |
|---------------------|---------------|-------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Ninotsminda field | 24,000 | 16,440 |
| Nazvrevi/Block XIII | 518,500 | 458,873 |
| | ----- | ----- |
| Total | 542,500 | 475,313 |

</TABLE>

The Company leases office space in Calgary (Alberta), Houston (Texas), Tbilisi (Republic of Georgia), and Maidenhead (England) under leases having remaining terms varying from one to __ months. The Company has subleased its Maidenhead offices.

LEGAL PROCEEDINGS

Zhoda Litigation

On February 20, 1998, Zhoda Corporation ("Zhoda") filed suit against the Company in the District Court of Harris County, Texas. Zhoda had sold to the Company shares in a subsidiary through which the Company acquired most of its interest in the Lelyaki field project. Substantially all of the consideration payable to Zhoda was contingent upon achievement of specified Lelyaki field operating objectives, and because these objectives were not achieved, the Company did not pay the consideration. In the litigation, Zhoda asserts that it was wrongfully deprived of the value of the shares it transferred to

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the Company and of the contingent consideration it might have received, based upon claims of breach of contract, breach of fiduciary duty and duty of good faith and fair dealing, fraud and constructive fraud, fraud in the inducement, negligent misrepresentation, civil conspiracy, breach of trust, unjust enrichment and rescission. Zhoda is seeking more than \$7,500,000 in damages, return of the shares transferred to the Company, and other relief. The Company believes it has meritorious defenses to Zhoda's claims which it intends to assert vigorously.

The Harris County District Court has stayed the litigation pending completion of arbitration proceedings, which are being held in Calgary, Alberta.

On March 24, 1998, the Company filed an action against Zhoda in the Court of Queen's Bench of Alberta, Judicial Centre of Calgary, in which the Company seeks to recover \$190,000, plus interest, which the Company asserts Zhoda owes the Company pursuant to promissory notes and loan agreements. On March 31, 1998, Zhoda filed a statement of defense and a counterclaim in which it asserted essentially the same claims as were asserted in the Texas action described above. On the basis of its counterclaim, Zhoda seeks relief similar to that sought in the Texas action. The Company's claim against Zhoda in the Alberta action is not within the scope of the arbitration proceeding being conducted in Calgary.

A judgment in favor of Zhoda on its claims could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

Ribalta Litigation

On March 9, 1998, Ribalta Holdings, Inc. ("Ribalta"), which sold to the Company shares in a subsidiary through which the Company acquired most of its interest in the Maykop field project, filed suit against the Company in the Third Judicial District Court of Salt Lake County, Utah. Ribalta, however, has not yet served the complaint on the Company.

In its complaint, Ribalta alleges breach by the Company of the contract governing the sale of the shares it transferred to the Company and failure of a condition in that contract that should have resulted in the termination of the contract. Ribalta seeks the return of all benefits conferred on the Company pursuant to the contract or damages equal to the value of such benefits, as well as other relief. Under that contract, as amended, the maximum consideration to which Ribalta might have been entitled was \$800,000 and 350,000 shares of Company Common Stock. The Company believes that no consideration is payable under that contract because conditions to payment specified in the contract were not satisfied. An outcome of this proceeding unfavorable to the Company could have a material adverse impact on the Company's financial condition, results of operations and cash flows. The Company believes it has meritorious defenses to Ribalta's claims which it intends to assert vigorously.

Potential Claims Relating to Previously Impaired Projects

As a result of the Company's decision to cease active development of the Lelyaki, Maykop and Gorisht-Kocul projects, the Company may be subject to contingent liabilities in the form of claims from the joint ventures developing such projects or from others participating in those projects. The Company was advised during the first quarter of 1998 that Intergas and another shareholder of Intergas were considering asserting such claims in relation to the Maykop project, but no such claims have yet been asserted. The Company is unable to estimate the range that such claims, if made, might total. However,

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if one or more such claims were asserted and determined to be valid, they could have a material adverse effect on the Company's financial position, results of operations and cash flows. Such claims may be adjudicated in the host country forum under host country laws.

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MANAGEMENT

EXECUTIVE OFFICERS AND DIRECTORS

The executive officers, directors and significant employees of the Company are as follows:

<TABLE>

<CAPTION>

| Name | Age | Position |
|--------------------------|-----|---|
| - - - - - | --- | ----- |
| <S> | <C> | <C> |
| David Robson | 40 | Chairman of the Board and Chief Executive Officer |
| Michael R. Binnion | 38 | Director, President and Chief Financial Officer |
| Robert A. Halpin (1) | 63 | Director |
| J.F. Russell Hammond (2) | 57 | Director |
| Peder Paus (1) | 53 | Director |
| Nils N. Trulsvik (2) | 50 | Director |
| Ron Gerlitz | 44 | Vice President, Technology |
| Anthony J. Potter | 34 | Vice President, Finance |
| Ravinder Sierra | 46 | Vice President (Significant Employee) |
| Niko Tevzadze | 33 | Vice President (Significant Employee) |

</TABLE>

- - - - -

- (1) Member of Audit Committee
- (2) Member of Compensation Committee

DAVID ROBSON was elected a Director, Chairman of the Board and Chief Executive Officer on July 15, 1998. He has also served as a Director, Chairman of the Board and Chief Executive Officer of the Company's subsidiary, CanArgo Oil & Gas Inc., since July 1997. From April 1992 until March 1997, Dr. Robson was a senior officer of JKC Oil & Gas plc, including Managing Director and Chief Executive Officer. He holds a B.Sc. (Hon) in Geology and a Ph.D in Geochemistry from the University of Newcastle upon Tyne, and an MBA from the University of Strathclyde. He is the energy sector representative on the United Kingdom government's East European Trade Council.

MICHAEL R. BINNION was elected a Director, President and Chief Financial Officer on July 15, 1998. He has also served as a Director, Chief Financial Officer and Secretary of the Company's subsidiary, CanArgo Oil & Gas Inc., since March 1997. Mr. Binnion is also President and a director of Terrenex Acquisition Corporation, an Alberta Stock Exchange listed investment company. He is also a director of NRI Online Inc., Fintech Services Ltd. and Smartor Products Inc. Prior to April 1997, he was Chief Financial Officer and a director of Trans-Dominion Energy Company, a Toronto Stock Exchange listed international exploration and production company, for years.

ROBERT A. HALPIN was elected a Director on March 4, 1995. He served as Chairman of the Board from November 14, 1995 to February 4, 1997 and as Vice Chairman of the Board from February 4, 1997 to July 15, 1998. Mr. Halpin has long experience in the oil and gas industry. Mr. Halpin has been a director of TransGlobe Energy Corporation, Synerseis Technologies Inc. and Pacific Tiger Energy Ltd., all Canadian companies, since 1997. From 1989 to his retirement in September 1993, he served as Vice President for International Exploration and Production with Petro-Canada. In October 1993, Mr. Halpin became President of

Halpin Energy Resources Ltd., a firm he formed to provide advisory services to energy companies with emphasis on international petroleum projects.

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J.F. RUSSELL HAMMOND was elected a Director on July 15, 1998. He has also served as a Director of the Company's subsidiary, CanArgo Oil & Gas Inc., since June 1997. For over five years, Mr. Hammond has been an investment advisor to Provincial Securities Ltd., a private investment company. Additionally, Mr. Hammond has been Chairman of Terrenex Acquisition Corporation since 1992.

PEDER PAUS was elected a Director on July 15, 1998 and is an independent businessman based in Oslo, Norway. Since 1995, he has been a consultant on investor relations for various companies. From 1981 to 1995, Mr. Paus was Chief Executive Officer of North Venture Ltd., a shipping and offshore consulting firm based in London, England.

NILS N. TRULSVIK was elected a Director of the Company on August 17, 1994. He has served the Company as President and Chief Executive Officer from February 4, 1997 to July 15, 1998 and from November 21, 1994 to March 9, 1995; and as Executive Vice President from March 9, 1995 to February 4, 1987 and from September 8, 1994 until November 21, 1994. In August 1998, Mr. Trulsvik became a partner in a consulting company, The Bridge Group, located in Norway. Mr. Trulsvik is a petroleum explorationist with extensive experience in petroleum exploration and development throughout the world. Prior to joining the Company, he held various positions with Nopec a.s., a Norwegian petroleum consultant group of companies of which he was a founder, including Managing Director from 1987 to 1993 and Special Advisor from 1993 to August 1994.

RON GERLITZ was elected Vice President, Technology on November 1, 1998. From 1997 to September 1998, he was Manager of Engineering with First Calgary Petroleums. From 1992 until 1997 he was an independent petroleum consultant in Calgary, Alberta, Canada. From 1983 to 1992, Mr. Gerlitz worked as an engineer in various capacities and positions with a number of corporations, including Mobil Oil. In 1983, he graduated from the University of Calgary with a Bachelor of Science in Engineering.

ANTHONY J. POTTER was elected Vice President, Finance on July 15, 1998. He also serves the Company as Group Controller. He has served as Vice President Finance and Group Controller of the Company's subsidiary, CanArgo Oil & Gas Inc., since May 1998. From September 1986 to April 1998, Mr. Potter was employed with Coopers & Lybrand Chartered Accountants. In 1986, he graduated from the University of Calgary with a Bachelor of Commerce degree in Accounting.

RAVINDER S. SIERRA was elected Vice President on July 15, 1998 and has served as Vice President of the Company's subsidiary, EOR International Inc., since December 15, 1994. Mr. Sierra first joined EOR International Inc. in November 1990 as Senior Project Engineer. Mr. Sierra has over 16 years experience in the international oil and gas industry.

NIKO TEVZADZE was elected Vice President on July 15, 1998. He has been the General Director of Georgian British Oil Company, which operates the Ninotsminda field on behalf of the Company, since October 1993. From 1991 to 1993, Mr. Tevzadze was involved in the joint venture "Georgia Makoil" as a General Director. From 1986 to 1991, he worked at the East Georgia Drilling Office of Georgian Oil as foreman, drilling engineer and chief technologist.

Directors hold office until the next annual meeting of stockholders and until their successors are duly elected and qualified. Officers serve at the pleasure of the Board of Directors.

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INDEMNIFICATION AND INSURANCE

The Company's Bylaws require the Company to indemnify its officers and directors to the full extent permitted by Delaware law. The Bylaws also require the Company to advance payment of expenses to an indemnified party so long as he agrees to repay the amount advanced if it is later determined that he is not entitled to indemnification. The Company carries directors' and officers' liability insurance covering losses arising from claims based on breaches of duty, negligence, error and other wrongful acts.

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table shows all compensation paid or accrued by the Company during the fiscal year ended August 31, 1996, the four month period ended December 31, 1996 and the fiscal years ended December 31, 1997 and December 31, 1998 with respect to certain current and former executive officers of the Company (the "Named Officers").

<TABLE>

<CAPTION>

| Name and Principal Position (\$) | Year Ended | Annual Compensation | Long-Term Compensation | |
|--|---------------|---------------------|--|-------------------------------|
| | | Salary (\$) | Securities Underlying Options/SARs (#) | All Other Compensation (5) |
| ----- | ----- | ----- | ----- | ----- |
| - | | | | |
| <S> | <C> | <C> | <C> | <C> |
| David Robson (1) | 12/98 | 82,500 | 390,000 | 0 |
| Nils N. Trulsvik (2) | 12/98 | 87,376 | 0 | 3,681 |
| | 12/97 | 140,333 | 0 | 6,653 |
| | 12/96* | 51,834 | 50,000 | 5,679 |
| | 8/96 | 161,241 | 0 | 8,635 |
| Rune Falstad (3) | 12/98 | 112,852 | 25,000 | 3,786 |
| | 12/97 | 82,952 | 15,000 | 3,825 |
| Alfred Kjemperud (4) | 12/98 | 133,338 | 50,000 | 3,124 |
| | 12/97 | 101,296 | 5,000 | 5,014 |
| | 12/96* | 38,875 | 10,000 | 2,342 |

</TABLE>

* Four month period ended December 31, 1996.

- (1) Mr. Robson has served as Chief Executive Officer since July 15, 1998 and is employed by the Company through Vazon Energy Limited.
- (2) Mr. Trulsvik served as President and Chief Executive Officer from February 4, 1997 to July 15, 1998 and as Executive Vice President from March 9, 1995 to February 4, 1997. Included in 1998 salary is \$1,671 paid as non-employee director's fees subsequent to July 31, 1998. See "Employment Contracts" and "Directors' Compensation".

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- (3) Mr. Falstad has served as Vice President since June 3, 1997, but has not been deemed an executive officer of the Company since October 1998.

Included in 1998 salary are payments made for consulting services rendered to the Company subsequent to July 31, 1998 pursuant to a contract with FinCom AS, of which Mr. Falstad is a partner. See "Employment Contracts".

- (4) Mr. Kjemperud resigned as Vice President on September 3, 1998. Included in 1998 salary are payments made for consulting services rendered to the Company subsequent to September 3, 1998 pursuant to a contract with The Bridge Group. See "Employment Contracts".
- (5) Represents the Company's contributions to or accruals with respect to individual retirement and pension plans.

OPTION GRANTS DURING FISCAL YEAR 1998

The following table sets forth information concerning options granted to the Named Officers during the year ended December 31, 1998.

<TABLE>
<CAPTION>

| Value(2) | | Number of Securities Underlying | % of Total Options Granted to | | | Grant Date Present |
|----------|------------------|---------------------------------|-------------------------------|------------|---------------|--------------------|
| | | Options | Employees | Exercise | Expiration | ----- |
| Total | Name | Granted (1) | in FY 12/98 | Price | Date | Per Share |
| ----- | ---- | ----- | ----- | ----- | ---- | ----- |
| <S> | | <C> | <C> | <C> | <C> | <C> |
| <C> | | | | | | |
| \$ | David Robson | 120,000 | 16.58% | \$0.69 | 10/6/08 | \$ |
| | Nils N. Trulsvik | 270,000 0 | 37.30 -- | 1.25 -- | 7/16/08 -- | -- |
| -- | Rune Falstad | 25,000 | 3.45 | 0.70 | 12/16/00 | |
| | Alfred Kjemperud | 50,000 | 6.91 | 0.70 | 12/16/00 | |

</TABLE>

- (1) The options granted to Mr. Robson vest in three equal annual installments commencing on the first anniversary of the grant date and were granted at an exercise price equal to the fair market value of the Company's Common Stock on the date of grant. The options granted to Messrs. Falstad and Kjemperud are exercisable only from November 16, 2000 through the expiration date of December 16, 2000, and were granted at an exercise price equal to 124% of the fair market value of the Company's Common Stock on the date of grant. Pursuant to the terms of the Company's various stock option plans, the Compensation Committee may, subject to each plan's limits, modify the terms of outstanding options, including the exercise price and vesting schedule thereof.

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- (2) These values were derived using the Black-Scholes option pricing model applying the following assumptions:

<TABLE>
<CAPTION>

| Exercise Price | Dividend Yield | Volatility | Risk Free Interest Rate | Expected Term |
|----------------|----------------|------------|-------------------------|---------------|
| ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |

| | |
|--------|----|
| \$0.69 | 0% |
| 1.25 | 0 |
| 0.70 | 0 |

These values are not intended to forecast future appreciation of the Company's stock price. The actual value, if any, that an executive officer may realize from his options (assuming that they are exercised) will depend solely on the increase in the market price of the shares acquired through option exercises over the exercise price, measured when the shares are sold.

OPTION VALUES AT DECEMBER 31, 1998

The following table sets forth information concerning the number and hypothetical value of stock options held by the Named Officers at December 31, 1998.

<TABLE>
<CAPTION>

| Money (1) | Name | Number of Shares Underlying Unexercised Options Held at Fiscal Year End | | Value of Unexercised In-the- Options at Fiscal Year End | |
|--------------|------------------|--|---------------|--|---------------|
| | | Exercisable | Unexercisable | Exercisable (\$) | Unexercisable |
| ---- | ----- | ----- | ----- | ----- | ----- |
| (\$) | ---- | ----- | ----- | ----- | ----- |
| ---- | ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> | <C> |
| | David Robson | 75,000 | 495,000 | \$0 | \$0 |
| | Nils Trulsvik | 30,000 | 0 | 0 | 0 |
| | Rune Falstad | 0 | 25,000 | 0 | 0 |
| | Alfred Kjemperud | 0 | 50,000 | 0 | 0 |

(1) The exercise price of all options exceeded the market value of the Common Stock on December 31, 1998.

DIRECTORS' COMPENSATION

The Company does not currently pay directors' fees, but it does reimburse ordinary out-of-pocket expenses for attending Board and Committee meetings. From July 15, 1998 until October 1, 1998, the Company paid non-employee directors fees at the rate of \$10,000 per year. Prior thereto, the Company paid non-employee directors (other than Mr. Halpin) fees at the rate of \$14,000 per year plus a fee of \$3,000 per year for each committee on which such non-employee director served. The Company also previously paid a fee of \$1,000 per day, other than a day on which the Board met, for each day spent by a non-employee director on the business of Board committees which exceeded one day per year with respect to the Compensation Committee and three days per year with respect to the Audit Committee and the Petroleum Committee.

From January 1998 through July 15, 1998, Robert A. Halpin was compensated for his services as Vice Chairman of the Board and member of Board committees pursuant to an agreement which provided

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for an annual fee of \$45,000 plus \$1,000 per day for each day of service in excess of 66 days per year. During that period, the Company also provided Mr. Halpin with an office at the Company's offices located in Calgary, Alberta, Canada, and reimbursed Mr. Halpin for his out-of-pocket expenses in connection with services on behalf of the Company. The Company also from time to time used the consulting services of Halpin Energy Resources, Ltd., which is controlled by Mr. Halpin, in the area of petroleum projects, for which such company was compensated at its customary rates.

The Company from time to time uses the consulting services of The Bridge Group, of which Mr. Trulsvik is a partner, for which such company is compensated at its customary rates.

From January 1, 1996 to July 15, 1998, Eugene Meyers, a non-employee director until July 15, 1998, provided financial relations consulting services to the Company at the rate of \$15,000 per year for 22 days of service, and thereafter at the rate of \$100 per hour (\$1,000 maximum per day). The Company also reimbursed him for his out-of-pocket expenses associated with such services.

The Company provides automatic grants of non-qualified options to non-employee directors pursuant to the 1995 Long-Term Incentive Plan. Pursuant to the Plan, a non-qualified option to purchase 3,750 shares of Common Stock is granted automatically to each non-employee director on each of (i) the date of each meeting of stockholders at which such non-employee is elected or re-elected as a director or, if in any fiscal year directors are not elected at a meeting of stockholders, on the last date of such fiscal year and (ii) the date such non-employee is first elected as a director, if not at a meeting of stockholders. In addition, a non-employee director will automatically be granted a non-qualified option to purchase 3,750 shares of Common Stock on each date on which such non-employee director is elected or re-elected by the Board of Directors as Chairman of the Board of Directors, or, if the Chairman of the Board is then an employee of the Company, as Vice Chairman of the Board of Directors. The exercise price of each option is equal to 100% of the fair market value of the Common Stock on the date of grant. Each option so granted is 100% vested six months after the date of grant. Options expire on the first to occur of three years from the date of grant or the first anniversary of the date the director ceases to be a director for any reason. Non-employee directors are not eligible to receive other options pursuant to the 1995 Long-Term Incentive Plan.

The following table shows the compensation paid to all persons who were non-employee directors, including their respective affiliates, during the year ended December 31, 1998:

<TABLE>
<CAPTION>

| Name | Directors Fees and Other Compensation | Consulting Payments | Options Granted |
|------------------------|---|------------------------|--------------------|
| - - - - - | - - - - - | - - - - - | - - - - - |
| <S> | <C> | <C> | <C> |
| Robert A. Halpin | \$26,293 | \$ 0 | 3,750 (3) |
| Russell Hammond | 2,137 | 0 | 3,750 (4) |
| Stanley D. Heckman (1) | 10,685 | 0 | -- |
| Eugene J. Meyers (1) | 7,537 | 43,100 (2) | -- |
| Peder Paus | 2,137 | 0 | 3,750 (4) |
| Nils N. Trulsvik | 1,671 | 0 | -- |

</TABLE>

(1) Messrs. Heckman and Meyers served as a non-employee directors until July 15, 1998.

(2) Includes \$35,600 for services rendered during 1997.

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- (3) The options were granted on December 31, 1998 at an exercise price of \$0.313 per share, expire on December 30, 2001 and will be 100% vested at June 30, 1999.
- (4) The options were granted on July 15, 1998 at an exercise price of \$1.00 per share, expire on July 14, 2001 and were 100% vested at January 15, 1999.

EMPLOYMENT CONTRACTS

The Company had employment contracts with Nils Trulsvik, Rune Falstad and Alfred Kjemperud which were terminated effective July 31, 1998. The contracts provided for annual salaries of approximately \$150,000 in the case of Mr. Trulsvik, approximately \$125,000 in the case of Mr. Falstad and approximately \$100,000 in the case of Mr. Kjemperud. In addition, each person received an allowance equal to 12.5% of his base salary, a portion of which was used to provide minimum life and disability insurance coverage for each such person. The remainder of such allowance was used by each person for additional life, medical or accident insurance and to fund individual pension and retirement plans.

The Company has entered into consulting arrangements with each of Messrs. Robson, Trulsvik, Falstad and Kjemperud. Mr. Robson's services are provided through Vazon Energy Limited (of which he is Managing Director) at the rate of \$12,000 per month plus expenses. Mr. Trulsvik's consulting services are provided through The Bridge Group (of which Mr. Trulsvik is a partner) pursuant to a work order dated August 1, 1998 between the Company and Mr. Trulsvik at the rate of \$1,200 per day plus expenses. No consulting services have been provided by Mr. Trulsvik as of December 1998. Mr. Falstad's consulting services are provided through FinCom AS (of which Mr. Falstad is a principal) under an agreement that commenced August 1, 1998 at the rate of \$7,000 per month plus expenses. This agreement may be terminated by either party upon 90-day notice. Mr. Kjemperud's consulting services are provided through The Bridge Group pursuant to a one-year work order commencing August 1, 1998 between the Company and Mr. Kjemperud at the rate of \$13,000 per month plus expenses.

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CERTAIN TRANSACTIONS

Nicholas G. Dobrotwir served as Vice President of the Company from September 1997 until January 26, 1998. He continues to provide consulting services to the Company. Pursuant to a Memorandum of Agreement dated May 16, 1995 between Fielden Management Services Pty, Ltd. ("Fielden") and the Company, under which the Company acquired its interest in the Stynawske field, in the first quarter of 1997 the Company paid \$500,000 and issued 87,500 shares of Common Stock having a value of \$1,060,938 in connection with an agreement to develop and operate the Stynawske field project. Mr. Dobrotwir has indirect beneficial ownership of the 87,500 shares of Common Stock owned by Fielden. Under the agreement, Fielden has the contingent right to receive up to an additional 187,500 shares of the Company's Common Stock subject to the satisfaction of conditions related to the achievement of specified performance standards by the Stynawske field project.

During the year ended December 31, 1997, the Company paid consulting fees and expenses to Fielden related to the Stynawske field project. Mr. Dobrotwir was the President and Chief Executive Officer of Fielden until his resignation May 5, 1997. Mr. Dobrotwir's services as a consultant were provided to the Company through Fielden from January 1997 through April 1997. After April 30, 1997, Mr. Dobrotwir's services were provided pursuant to a Management Services Agreement with Trident Petroleum Inc. The Company paid a total of

\$288,065.20 to Fielden during the year ended December 31, 1997, of which \$111,562.50 related to consultant services provided by Mr. Dobrotwir, and paid \$100,000 to Trident Petroleum Inc. for Mr. Dobrotwir's services.

Orest Senkiw served as a Vice President of the Company from February 4, 1997 to December 1, 1997. Mr. Senkiw, his wife and his two adult children each owns 25% of the corporation that holds 10.3% of the outstanding shares of Zhoda Corporation. Mr. Senkiw was the Company executive who, during 1997, had the principal operating responsibilities for the Lelyaki field project. On April 26, 1997, Zhoda transferred an effective 36% ownership interest in the Lelyaki field project to the Company. In consideration for the transfer, a subsidiary of the Company assumed a \$450,000 obligation owed by Zhoda to the Company and issued to Zhoda special non-voting common shares of that subsidiary which could be exchanged for 500,000 shares of the Company's Common Stock if certain conditions relating to performance by the Lelyaki field were achieved. The Company believes that all of Zhoda's rights to exchange the special shares terminated during 1997 because the conditions were not satisfied. Zhoda has filed suit against the Company in connection with this transaction. See "BUSINESS -- Legal Proceedings."

As of December 31, 1998, Zhoda was indebted to the Company in the principal amount of \$ _____ .

The Company is a 50% shareholder of CanArgo Power Corporation, which in turn owns 85% of a Georgian private power company. The other 50% of CanArgo Power is owned by Terrenex Acquisition Corporation, an entity that is affiliated with two of the Company's directors and is itself a principal stockholder of the Company. Michael R. Binnion is President and a director of both the Company and Terrenex, and J. F. Russell Hammond is a director of the Company and Chairman of Terrenex. During the first half of 1998, Terrenex, on behalf of both itself and the Company, provided all of the funds required by CanArgo Power. After the July 1998 business combination with CanArgo Oil & Gas Inc. was completed, the Company reimbursed Terrenex \$398,000, representing half of the amount that had been advanced through that time. The Company and Terrenex have funded CanArgo Power equally since that time.

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In May 1998, Terrenex agreed to lend CanArgo Oil & Gas Inc. up to \$1,000,000 through August 31, 1998 and subsequently advanced the \$1,000,000. CanArgo Oil & Gas Inc. paid Terrenex a \$10,000 commitment fee, \$50,000 in draw down fees and interest at the rate of 1/2% per month. In addition, CanArgo Oil & Gas Inc. granted Terrenex options exercisable until December 31, 1998 to acquire 12 1/2% of the stock of the subsidiary holding the Nazvrevi/Block XIII production sharing contract and 15% of CanArgo Oil & Gas Inc.'s position in any license received as a result a consortium submission in response to the Dagestan tender for offshore drilling and production rights. The terms of the loan were negotiated and approved by the directors of CanArgo Oil & Gas Inc. who had no affiliation with Terrenex. The Company subsequently extended the options through March 31, 1999 in consideration of the efforts of Terrenex in attempting to arrange financing for the Company. Terrenex can exercise either option by paying the percentage of the amounts expended on such projects through the exercise date as equals the percentage of the project being acquired through the exercise of the option. The Company repaid the Terrenex loan following completion of the business combination in July 1998.

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OWNERSHIP OF VOTING SECURITIES

DESCRIPTION OF VOTING SECURITIES

The voting securities of the Company consist of Common Stock and Special

Voting Stock. Generally, the Common Stock and Special Voting Stock are voted together as a single class on all matters. The Common Stock is entitled to one vote per share. The Special Voting Stock is entitled generally to that number of votes as is equal to the number of Exchangeable Shares issued by CanArgo Oil & Gas Inc., a subsidiary of the Company, as are outstanding from time to time. The Special Voting Stock is held of record by Montreal Trust Company of Canada, which holds such stock in trust for the benefit of the holders of the Exchangeable Shares. The Special Voting Stock is voted in the manner directed by the holders of the Exchangeable Shares. The Exchangeable Shares may be exchanged for shares of Common Stock on a share-for-share basis. For purposes of the following tables, the term "Voting Securities" refers to the Common Stock and the Exchangeable Shares as though they were a single class of voting securities. See "DESCRIPTION OF CAPITAL STOCK."

SECURITY OWNERSHIP BY MANAGEMENT

The following table sets forth information with respect to beneficial ownership of the Voting Securities by each director and Named Officer of the Company and by all directors and executive officers of the Company as a group as of January 31, 1999, and as adjusted to give effect to the Minimum Offering and the Maximum Offering. Unless otherwise noted, each stockholder has sole voting and investment power as to the shares shown.

<TABLE>

<CAPTION>

| Beneficial Ownership Name Maximum Offering ----- ----- | Beneficial Ownership Prior to Offering | | Beneficial Ownership After Minimum Offering | | After ----- |
|--|---|------------|--|------------|---------------------|
| | Number of Shares | Percentage | Number of Shares | Percentage | Number of Shares |
| Percentage ----- | ----- | ----- | ----- | ----- | ----- |
| <S> <C> | <C> | <C> | <C> | <C> | <C> |
| Michael Binnion | 424,432 (1) | 2.07% | | | |
| Peder Paus | 365,894 (2) | 1.81% | | | |
| Nils N. Trulsvik | 103,700 (3) | * | | | |
| David Robson | 75,000 (4) | * | | | |
| J.F. Russell Hammond | 28,750 (5) | * | | | |
| Robert A. Halpin | 21,000 (6) | * | | | |
| Rune Falstad | 10,500 | * | | | |
| Alfred Kjemperud | 0 | 0 | | | |
| All executive officers and directors as a group (8 persons) | 1,038,776 (7) | 5.02% | | | |

</TABLE>

* Less than 1%.

- (1) Includes 216,636 Exchangeable Shares and 58,333 shares underlying presently exercisable options beneficially owned directly by Mr. Binnion. Also includes 125,463 shares, but excludes 2,197,928 shares beneficially owned by Terrenex Acquisition Corporation of which Mr. Binnion is President, a director and an approximately 5.4% shareholder. Mr. Binnion disclaims beneficial ownership of all shares beneficially owned by Terrenex, other than the 125,463 shares which represent his 5.4% proportionate interest. See "Top 20 Holders of Voting Securities" below.

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- (2) Includes 15,715 shares underlying presently exercisable warrants to acquire Exchangeable Shares and 3,750 shares underlying presently exercisable options.
- (3) Includes 30,000 shares underlying presently exercisable options.
- (4) Represents 75,000 shares underlying presently exercisable options.
- (5) Represents 28,750 shares underlying presently exercisable options. Excludes 2,323,391 shares owned by Terrenex Acquisition Corporation of which Mr. Hammond is Chairman, and 1,671,250 shares owned by Provincial Securities Limited for which Mr. Hammond is an investment advisor as to which Mr. Hammond disclaims beneficial ownership. See "Top 20 Holders of Voting Securities" below.
- (6) Includes 15,000 shares underlying presently exercisable options.
- (7) See Notes 1-6; also includes 20,000 shares underlying presently exercisable options held by an executive officer not named in the foregoing table.

TOP 20 HOLDERS OF VOTING SECURITIES

Except as noted with respect to Terrenex Acquisition Corporation and Provincial Securities Limited, the following table sets forth information with respect to the top 20 record holders of the Voting Securities as shown on the stock and warrant records of the Company and CanArgo Oil & Gas Inc. as of January 31, 1999, and as adjusted to give effect to the Minimum Offering and the Maximum Offering. Only Terrenex Acquisition Corporation and Provincial Securities Limited are known to the Company to be the beneficial owners of more than 5% of the Voting Securities.

<TABLE>

<CAPTION>

| Record Ownership | | Record Ownership | | |
|---|------------|-------------------|------------------------|----|
| | | Prior to Offering | After Minimum Offering | |
| After Maximum Offering | | ----- | ----- | -- |
| ----- | | | | |
| Number of Name Shares | Percentage | Number of | | |
| | | Shares | Percentage | |
| ---- | ----- | ----- | ----- | - |
| <S> | | <C> | <C> | |
| Terrenex Acquisition Corporation 1580, 727 -7th Avenue, S.W. Calgary, Alberta T2P 0Z5 CANADA | | 2,323,391(1) | 11.27% | |
| Provincial Securities Limited 607 Gilbert House, Barbican London EC2Y 8BD UNITED KINGDOM | | 1,671,250(2) | 8.27% | |
| Independent Oilfield | | 778,000 | 3.85% | |
| B.A.S.E | | 708,750 | 3.51% | |
| Roytor & Co. | | 472,500 | 2.34% | |

</TABLE>

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<TABLE>

<CAPTION>

| Record Ownership | | Record Ownership | |
|-----------------------------|------------|-------------------|------------------------|
| After Maximum Offering | | Prior to Offering | After Minimum Offering |
| ----- | | ----- | ----- |
| Number of Name Shares | Percentage | Number of | |
| | | Shares | Percentage |
| ----- | ----- | ----- | ----- |
| <S> | | <C> | <C> |
| <C> | <C> | | |
| Gjensidige Kapital | | 425,000 | 2.10% |
| v/Gjensidige Fondsfo | | | |
| Michael R. Binnion | | 424,432(3) | 2.07% |
| Peder Paus | | 365,894(4) | 1.81% |
| Grizzly Investment Fund | | 346,416 | 1.71% |
| Allen Firstenberg | | 266,364 | 1.32% |
| Yorkton Securities Inc. | | 254,100(5) | 1.24% |
| Unibank A/S S/A Collective | | | |
| Clie | | 238,950 | 1.18% |
| Part Invest AS | | 200,000 | 0.99% |
| Eurosecurities Limited | | 189,200(6) | 0.93% |
| American Enterprises | | 157,500 | 0.78% |
| Okla Finans (Fonds Market | | | |
| Making) | | 138,815 | 0.69% |
| Arnfred Alvestad | | 134,000 | 0.66% |
| G-Fondspar 2020 | | | |
| v/Gjensidige Fondsfo | | 120,000 | 0.59% |
| Southwest Capital Group | | | |
| Inc. | | 119,444 | 0.59% |
| Arne Hellesto AS | | 106,800 | 0.53% |

</TABLE>

(1) Includes 415,360 shares underlying presently exercisable warrants to acquire Exchangeable Shares. Michael Binnion is President, a director and an approximately 5.4% shareholder and J.F. Russell Hammond is Chairman of Terrenex Acquisition Corporation.

(2) J.F. Russell Hammond is an investment advisor to Provincial Securities Ltd.

(3) See Note 1 - "Security Ownership by Management."

- (4) See Note 2 - "Security Ownership by Management."
- (5) Represents Exchangeable Shares.
- (6) Represents shares underlying presently exercisable warrants to acquire Exchangeable Shares.

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DESCRIPTION OF CAPITAL STOCK

The Company's Certificate of Incorporation authorizes the Company to issue 50,000,000 shares of Common Stock, \$.10 par value per share, and 5,000,000 shares of Preferred Stock, \$.10 par value per share. The Company has authorized a class of Preferred Stock referred to as "Special Voting Stock." As of February 3, 1999, there were 19,381,120 shares of Common Stock and 100 shares of Special Voting Stock outstanding.

COMMON STOCK

Holders of Common Stock have no preferences or preemptive, conversion, or exchange rights. Subject to any preferential rights of any shares of Preferred Stock which may be outstanding, holders of shares of Common Stock are entitled to receive dividends if approved by the Board of Directors and to share ratably in the Company's assets legally available for distribution to its stockholders in the event of its liquidation, dissolution or winding-up. The Company may not pay dividends on its Common Stock unless its subsidiary, CanArgo Oil & Gas Inc., is able to pay and simultaneously pays an equivalent dividend on the Exchangeable Shares described below.

Holders of Common Stock are entitled to one vote per share on all matters voted on generally by the stockholders, including the election of directors. Cumulative voting for the election of directors is not permitted. Except as otherwise required by law or except as any series or class of Preferred Stock, such as the Special Voting Stock, may provide, the holders of Common Stock possess all voting power.

The shares of Common Stock to be issued in this offering, when issued and paid for, will be fully paid and non-assessable.

PREFERRED STOCK

The Board of Directors is authorized at any time and from time to time, without any further vote or action by the Company's stockholders, to provide for the issuance of all or any shares of Preferred Stock in one or more classes or series. The Board of Directors may set the terms and provisions of each such class or series by resolution, including provisions regarding voting, liquidation preference, redemption, conversion and the right to receive dividends. The Board of Directors has authorized one class of Preferred Stock, which we refer to in this Prospectus as "Special Voting Stock". The Board of Directors has no present plans to issue any additional shares of Preferred Stock.

The issuance of Preferred Stock, while providing desirable flexibility in connection with possible acquisitions, financings and other corporate transactions, may have the effect of discouraging, delaying or preventing a change in control of the Company. Since the voting rights to be accorded to any series of Preferred Stock remain to be fixed by the Board, the holders of Preferred Stock may, if the Board so authorizes, be entitled to vote separately as a class in connection with approval of certain extraordinary corporate transactions in circumstances where Delaware law does not require a class vote, or might be given a disproportionately large number of votes. Such Preferred Stock could also be convertible into a large number of shares of Common Stock

under certain circumstances or have other terms which could make it more difficult or costly for a third party to acquire a significant interest in the Company. Also, shares of Preferred Stock could be privately placed with purchasers who might side with the management of the Company in opposing a hostile tender offer or other attempt to obtain control. As a result, the issuance of Preferred Stock as an anti-takeover device might preclude stockholders from

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taking advantage of a situation which might be favorable to their interests. See "RISK FACTORS - Future stock issuances could have anti-takeover effects."

SPECIAL VOTING STOCK

In connection with the July 1998 business combination, the Company's Board of Directors authorized a class of Preferred Stock, referred to as "Special Voting Stock", consisting of 100 shares. The Special Voting Stock was issued to Montreal Trust Company of Canada, which is holding such shares as trustee for the benefit of the holders of the Exchangeable Shares described below. Except as otherwise required by law or the Company's Certificate of Incorporation, each share of Special Voting Stock is entitled to a number of votes equal to the quotient (rounded down to the nearest whole number) obtained by dividing the number of outstanding Exchangeable Shares from time to time not owned by the Company by the number of shares of Special Voting Stock outstanding as of the applicable record date. The Special Voting Stock may be voted in the election of directors and on all other matters submitted to a vote of stockholders of the Company. The holders of Common Stock and the holder of the Special Voting Stock vote together as a single class on all matters, except to the extent voting as a separate class is required by applicable law or the Company's Certificate of Incorporation. In the event of any liquidation, dissolution or winding up of the Company, the holder of the Special Voting Stock will be entitled to receive the sum of \$1.00 per share from any assets of the Company available for distribution to its stockholders. The holder of the Special Voting Stock is not entitled to receive dividends. At such time as the Special Voting Stock has no votes attached to it because there are no Exchangeable Shares outstanding not owned by the Company and there are no shares of stock, debt, options or other agreements that could give rise to the issuance of any additional Exchangeable Shares to any person (other than the Company), the Special Voting Stock may be redeemed by the Company for a price of \$1.00 per share.

EXCHANGEABLE SHARES

In connection with the July 1998 business combination, the outstanding Common Shares of CanArgo Oil & Gas Inc. were exchanged for Exchangeable Shares issued by that corporation. The Exchangeable Shares may be exchanged at any time at the option of the holders for Company Common Stock on a share-for-share basis. As of February 3, 1999, there were 1,073,763 outstanding Exchangeable Shares and 1,907,271 Exchangeable Shares issuable upon exercise of warrants which may be exchanged for a total of 2,981,034 shares of the Company's Common Stock. The following is a summary of the principal terms and rights of the Exchangeable Shares which affect the Company and the holders of its Common Stock.

DIVIDENDS. Holders of Exchangeable Shares are entitled to receive dividends equal to the dividends paid by the Company on shares of its Common Stock.

VOTING RIGHTS. The holders of Exchangeable Shares are entitled to provide directions to the holder of the Company's Special Voting Stock as to the manner in which the Special Voting Stock should be voted with respect to any matter on which holders of the Company's Common Stock are entitled to vote. See "Special Voting Stock" above.

EXCHANGE EVENTS. Exchangeable Shares will be exchanged for shares of the

Company's Common Stock on a share-for-share basis, plus an amount equal to all declared and unpaid dividends on such Exchangeable Shares, whenever:

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- the holder requests CanArgo Oil & Gas Inc. to redeem his Exchangeable Shares;
- CanArgo Oil & Gas Inc. is liquidated, dissolved or wound-up;
- requested by the holder of the Special Voting Stock, in the event CanArgo Oil & Gas Inc. becomes insolvent or bankrupt, has a receiver appointed or similar event occurs;
- CanArgo Energy Corporation becomes involved in voluntary or involuntary liquidation, dissolution or winding-up proceedings;
- either CanArgo Oil & Gas Inc. or CanArgo Energy Corporation elects to redeem all of the Exchangeable Shares, provided the request is made after January 30, 2004 or the number of outstanding Exchangeable Shares in less than 853,071; or
- a holder of Exchangeable Shares instructs the holder of the Special Voting Stock to require the Company to purchase his Exchangeable Shares.

PROTECTION RIGHTS. Without the prior approval of CanArgo Oil & Gas Inc. and the holders of the Exchangeable Shares, the Company may not distribute additional shares of its Common Stock, subscription rights or other property or assets to all or substantially all holders of its Common Stock, or change the Common Stock, unless the same or an economically equivalent action is taken with respect to the Exchangeable Shares. The CanArgo Oil & Gas Inc. Board of Directors is conclusively empowered to determine in good faith and in its sole discretion whether any corresponding distribution on or change to the Exchangeable Shares is the same as or economically equivalent to any proposed distribution on or change to the Company's Common Stock. In the event of any proposed tender offer, share exchange offer, issuer bid, take-over bid or similar transaction affecting the Company's Common Stock, the Company must use reasonable efforts to take all actions necessary or desirable to enable holders of Exchangeable Shares to participate in such transaction to the same extent and on an economically equivalent basis as the holders of the Company's Common Stock. The Company has also agreed to take various actions to protect the rights of the holders of the Exchangeable Shares to receive the same dividends as are paid on the Company's Common Stock and to exchange shares of Company Common Stock for Exchangeable Shares.

LIMITATION ON LIABILITY

The Company's Certificate of Incorporation limits or eliminates the liability of the Company's directors or officers to the Company or its stockholders for monetary damages to the fullest extent permitted by the Delaware General Corporation Law. Delaware law provides that a director of the Company shall not be personally liable to the Company or its stockholders for monetary damages for a breach of fiduciary duty as a director, except for liability: (1) for any breach of such person's duty of loyalty; (2) for acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law; (3) for the payment of unlawful dividends any certain other actions prohibited by Delaware corporate law; and (4) for any transaction resulting in receipt by such person of an improper personal benefit.

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SECTION 203 OF DELAWARE GENERAL CORPORATION LAW

Section 203 of the Delaware General Corporation Law prohibits certain business combinations between a Delaware corporation and an "interested stockholder," which is defined as a person who, together with any affiliates or associates of such person, beneficially owns, directly or indirectly, 15% or more of the outstanding voting shares of a Delaware corporation. For purposes of Section 203, business combinations are defined broadly to include mergers, consolidations, sales or other dispositions of assets having an aggregate value in excess of 10% of the consolidated assets of the corporation, and certain transactions that would increase the interested stockholder's proportionate share ownership in the corporation. Section 203 prohibits any such business combination for a period of three years commencing on the date the interested stockholder becomes an interested stockholder, unless:

- the business combination is approved by the corporation's board of directors prior to the date the interested stockholder becomes an interest stockholder;
- the interested stockholder acquired at least 85% of the voting stock of the corporation (other than stock held by directors who are also officers or by certain employee stock plans) in the transaction in which it becomes an interested stockholder; or
- the business combination is approved by a majority of the board of directors and by the affirmative vote of two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Common Stock is Signature Stock Transfer, Inc., Dallas, Texas.

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SHARES ELIGIBLE FOR FUTURE RESALE

Upon completion of this offering, assuming that the Maximum Offering is sold, the Company will have outstanding _____ shares of Common Stock. Of these shares, approximately _____ shares will be freely tradable without restriction or further registration under the Securities Act unless purchased by "affiliates" of the Company, as that term is defined in Rule 144 under the Securities Act described below. An "affiliate" is generally an executive officer, director or stockholder of 10% of more of the equity securities the Company.

The only material restriction on the approximately _____ of the shares of Common Stock outstanding prior to this offering which are held by affiliates is the limitation on the number of shares that may be sold in any three-month period under Rule 144. In general, under Rule 144 as currently in effect, any person, including an affiliate, who has beneficially owned restricted shares for at least one year, and an affiliate with respect to all of his shares, is entitled to sell, within any three-month period, a number of shares at least equal to 1% of the number of then outstanding shares of Common Stock. In addition, a person who has not been an affiliate of the Company at any time during the 90 days preceding the sale and who has beneficially owned the shares proposed to be sold for at least two years, is entitled to sell an unlimited number of restricted shares.

In addition to the outstanding shares, at February 3, 1999 the Company had reserved the following shares for future issuance:

- 2,981,034 shares issuable upon exchange of the Exchangeable Shares outstanding and which may become outstanding upon exercise of warrants

to purchase Exchangeable Shares;

- 1,717,084 shares issuable upon exercise of outstanding stock options;
- 94,916 shares that may be issued upon exercise of options available for future grant under the Company's stock option plans; and
- 187,500 shares issuable in connection with an oil and gas project.

Of the foregoing shares, all but the 187,500 shares issuable in connection with an oil and gas project will be freely tradeable without restriction or further registration under the Securities Act, except for shares which may be acquired by affiliates of the Company which would be subject to Rule 144 as described above.

LEGAL MATTERS

Kelly Lytton Mintz & Vann, LLP, special securities counsel to the Company, has provided an opinion concerning the validity of the shares of Common Stock offered hereby. Alan D. Jacobson, a partner in that firm, owns 25,972 shares of the Company's Common Stock, representing less than 1% of the outstanding shares at February 3, 1999.

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EXPERTS

The consolidated financial statements of the Company for the year ended December 31, 1997, the four month period ended December 31, 1996, and the years ended August 31, 1996 and 1995 included in this Prospectus have been audited by PricewaterhouseCoopers LLP, independent accountants, as set forth in their report appearing herein, and have been included here in reliance upon the report of such firm, given upon the authority of such firm as experts in accounting and auditing.

The consolidated financial statements of CanArgo Oil & Gas Inc. for the six month period ended December 31, 1997 included in this Prospectus have been audited by Ernst & Young, Chartered Accountants, as set forth in their report appearing herein, and have been included here in reliance upon the report of such firm, given upon the authority of such firm as experts in accounting and auditing.

The financial statements of NOC for the periods ended June 30, 1997 and December 31, 1996, included in this Prospectus have been audited by Ernst & Young, Chartered Accountants, as set forth in their report appearing herein, and have been included here in reliance upon the report of such firm, given upon the authority of such firm as experts in accounting and auditing.

The AMH Report was prepared by AMH Group Ltd., a firm of independent petroleum consultants. Information from that report has been included in this Prospectus in reliance on the fact that AMH Group Ltd. is an expert in the evaluation of oil and gas reserves.

AVAILABLE INFORMATION

This Prospectus is part of a Registration Statement on Form S-1 (file no. _____) filed by the Company with the Securities and Exchange Commission. This Prospectus does not contain all of the information set forth in the Registration Statement. Additional information about the Company and its Common Stock is contained in the Registration Statement and the exhibits thereto. This Prospectus contains summary descriptions of some of the documents that are filed as exhibits to the Registration Statement. You should read the entire document filed as an exhibit and not rely solely on the summaries in the Prospectus.

The Company files reports with the SEC such as annual and quarterly reports, proxy and information statements, and other information. The public may read and copy any materials the Company files with the SEC, including the Registration Statement and its exhibits, at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC. The address of that site is: <http://www.sec.gov>.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Fountain Oil Incorporated:

We have audited the accompanying consolidated balance sheets of Fountain Oil Incorporated and subsidiaries (the "Company") as of December 31, 1997 and 1996 and August 31, 1996 and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four month period ended December 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 1997 and 1996 and August 31, 1996 and the consolidated results of their operations and their cash flows for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four month period ended December 31, 1996, in conformity with generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Notes 3 and 6 to the consolidated financial statements, the Company will require substantial capital in order to finance the development of its oil and gas interests. In addition, the Company and its oil and gas ventures must produce and market oil and gas in sufficient quantities and at sufficient prices to provide positive cash flow to the Company. As a result, there is substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 6 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

<TABLE>

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Houston, Texas

/S/ PRICEWATERHOUSECOOPERS LLP

March 9, 1998, except for
the sixth paragraph of Note
6 as to which the date is

COOPERS & LYBRAND L.L.P.

June 8, 1998 and the first paragraph of Note 1 as to which the date is February 11, 1999.

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CANARGO ENERGY CORPORATION

CONSOLIDATED BALANCE SHEET

AS OF DECEMBER 31, 1997, DECEMBER 31, 1996, AND AUGUST 31, 1996

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|---|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| ASSETS | | | |
| Cash and cash equivalents..... | \$ 14,164,177 | \$ 31,424,064 | \$ 17,329,237 |
| Accounts receivable -- affiliated entities..... | -- | 259,040 | 7,210 |
| Restricted cash..... | 9,700,000 | -- | -- |
| Other current assets..... | 761,904 | 622,411 | 649,107 |
| | ----- | ----- | ----- |
| Total current assets..... | 24,626,081 | 32,305,515 | 17,985,554 |
| Restricted cash..... | -- | 5,400,000 | -- |
| Notes receivable..... | -- | 190,186 | 190,186 |
| Property and equipment, net..... | 5,942,273 | 7,766,479 | 6,577,565 |
| Oil and gas properties, net, full cost method (including unevaluated amounts of \$324,500, \$257,407 and \$257,407, respectively)..... | 1,478,974 | 259,338 | 287,788 |
| Investments in and advances to oil and gas ventures -- net..... | 5,386,707 | 8,567,563 | 6,876,327 |
| Other assets..... | -- | 885,980 | 171,121 |
| | ----- | ----- | ----- |
| TOTAL ASSETS..... | \$ 37,434,035 | \$ 55,375,061 | \$ 32,088,541 |
| | ===== | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Accounts payable..... | \$ 328,171 | \$ 799,985 | \$ 731,532 |
| Accrued liabilities..... | 10,326,608 | 1,124,425 | 297,513 |
| Notes payable..... | -- | -- | 31,156 |
| | ----- | ----- | ----- |
| Total current liabilities..... | 10,654,779 | 1,924,410 | 1,060,201 |
| 8% Convertible subordinated debentures..... | -- | -- | 300,000 |
| Minority interest in subsidiaries..... | -- | 205,380 | 223,350 |
| Commitments and contingencies (Notes 6 and 9)..... | -- | -- | -- |
| Stockholders' equity: | | | |
| Preferred stock, par value \$0.10 per share, 5,000,000 shares authorized: no shares issued or outstanding..... | -- | -- | -- |
| Common Stock, par value \$0.10 per share, 50,000,000 shares authorized: 11,223,744, 11,084,244, and 8,688,304 shares issued and outstanding respectively..... | 1,122,374 | 1,108,424 | 868,830 |
| Capital in excess of par value..... | 83,162,531 | 81,959,545 | 56,854,403 |
| Accumulated deficit..... | (57,505,649) | (29,822,698) | (27,218,243) |
| | ----- | ----- | ----- |
| Total stockholders' equity..... | 26,779,256 | 53,245,271 | 30,504,990 |

TOTAL LIABILITIES AND STOCKHOLDERS'

| | | | |
|-------------|---------------|---------------|---------------|
| EQUITY..... | \$ 37,434,035 | \$ 55,375,061 | \$ 32,088,541 |
| | ===== | ===== | ===== |

</TABLE>

The accompanying notes are an integral part of the consolidated financial
statements

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CANARGO ENERGY CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 1997 AND AUGUST 31, 1996 AND 1995

<TABLE>

<CAPTION>

| | 1997 | 1996 | 1995 |
|--|----------------|---------------|---------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Operating Revenues: | | | |
| Oil and gas sales..... | \$ 313,301 | \$ 26,562 | \$ -- |
| Other..... | -- | 8,615 | 625,457 |
| | ----- | ----- | ----- |
| TOTAL REVENUES..... | 313,301 | 35,177 | 625,457 |
| | ----- | ----- | ----- |
| Operating expenses: | | | |
| Cost of sales..... | -- | 31,991 | 479,224 |
| Lease operating expenses..... | 200,321 | 10,988 | -- |
| Direct project costs..... | 1,753,166 | 1,267,555 | -- |
| General and administrative..... | 3,903,446 | 3,853,972 | 4,012,510 |
| Loss from investments in unconsolidated subsidiaries..... | 3,778,287 | 13,272 | -- |
| Depreciation, depletion and amortization..... | 344,666 | 77,253 | 1,156,772 |
| Employee stock compensation..... | -- | -- | 152,038 |
| Impairment of notes receivable..... | 186,611 | -- | -- |
| Impairment of property and equipment... | 3,243,997 | -- | 175,450 |
| Impairment of intangibles and other assets..... | -- | -- | 1,924,202 |
| Impairment of oil and gas properties... | 257,407 | 419,835 | 608,181 |
| Impairment of oil and gas ventures..... | 15,735,592 | -- | -- |
| | ----- | ----- | ----- |
| TOTAL OPERATING EXPENSES..... | 29,403,493 | 5,674,866 | 8,508,377 |
| | ----- | ----- | ----- |
| OPERATING LOSS..... | (29,090,192) | (5,639,689) | (7,882,920) |
| | ----- | ----- | ----- |
| Other (expense) income: | | | |
| Interest income..... | 1,615,066 | 332,071 | 251,276 |
| Interest expense..... | (69,286) | (1,016,465) | (28,475) |
| Other..... | (72,714) | 12,551 | 89,108 |
| Loss on disposition of equipment and property..... | (271,205) | (182,020) | -- |
| | ----- | ----- | ----- |
| TOTAL OTHER (EXPENSE) INCOME..... | 1,201,861 | (853,863) | 311,909 |
| | ----- | ----- | ----- |
| Net loss before income tax expense..... | (27,888,331) | (6,493,552) | (7,571,011) |
| Income tax expense..... | -- | -- | (28,600) |
| | ----- | ----- | ----- |
| NET LOSS BEFORE MINORITY INTEREST..... | (27,888,331) | (6,493,552) | (7,599,611) |
| Minority interest in loss of consolidated subsidiary..... | 205,380 | -- | -- |
| NET LOSS..... | \$(27,682,951) | \$(6,493,552) | \$(7,599,611) |

| | | | |
|--|------------|-----------|-----------|
| NET LOSS PER COMMON SHARE -- BASIC..... | \$ (2.47) | \$ (1.04) | \$ (1.82) |
| NET LOSS PER COMMON SHARE -- DILUTED..... | \$ (2.47) | \$ (1.04) | \$ (1.82) |
| Weighted average number of common shares outstanding..... | 11,206,506 | 6,247,568 | 4,170,891 |

</TABLE>

The accompanying notes are an integral part of the consolidated financial
statements

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CANARGO ENERGY CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE FOUR MONTH PERIODS ENDED DECEMBER 31, 1996 AND 1995

<TABLE>

<CAPTION>

| | 1996 | 1995 |
|--|---------------|---------------|
| | ----- | ----- |
| | | (UNAUDITED) |
| <S> | <C> | <C> |
| Operating Revenues: | | |
| Oil and gas sales..... | \$ 16,980 | \$ 6,440 |
| Other income..... | -- | 1,908 |
| TOTAL REVENUES..... | 16,980 | 8,348 |
| Operating expenses: | | |
| Cost of sales..... | 4,052 | 4,581 |
| Lease operating expenses..... | 1,550 | 2,536 |
| Direct project costs..... | 314,100 | 120,268 |
| General and administrative..... | 1,281,821 | 1,303,048 |
| Loss from investments in unconsolidated subsidiaries..... | 1,359,246 | 4,424 |
| Depreciation, depletion and amortization..... | 39,578 | 43,643 |
| TOTAL OPERATING EXPENSES..... | 3,000,347 | 1,478,500 |
| OPERATING LOSS..... | (2,983,367) | (1,470,152) |
| Other (expense) income: | | |
| Interest income..... | 423,681 | 54,992 |
| Interest expense..... | (12,744) | (3,006) |
| Other..... | (49,995) | (24,016) |
| TOTAL OTHER (EXPENSE) INCOME..... | 360,942 | 27,970 |
| Net loss before income tax expense..... | (2,622,425) | (1,442,182) |
| Income tax expense..... | -- | -- |
| NET LOSS BEFORE MINORITY INTEREST..... | (2,622,425) | (1,442,182) |
| Minority interest in loss of consolidated subsidiary..... | 17,970 | -- |
| NET LOSS..... | \$(2,604,455) | \$(1,442,182) |
| NET LOSS PER COMMON SHARE -- BASIC..... | \$ (0.28) | \$ (0.27) |

| | | |
|--|-----------|-----------|
| NET LOSS PER COMMON SHARE -- DILUTED..... | \$ (0.28) | \$ (0.27) |
| | ===== | ===== |
| Weighted average number of common shares outstanding..... | 9,348,106 | 5,417,031 |
| | ===== | ===== |

</TABLE>

The accompanying notes are an integral part of the consolidated financial
statements

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CANARGO ENERGY CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

FOR THE PERIOD AUGUST 31, 1994 THROUGH DECEMBER 31, 1997

<TABLE>

<CAPTION>

| | COMMON STOCK | | | | |
|--|-------------------------------|-------------|----------------------------------|------------------------|----------------------------------|
| | NUMBER OF SHARES ISSUED | PAR VALUE | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED DEFICIT | TOTAL STOCKHOLDERS' EQUITY |
| | ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> | <C> |
| BALANCE, AUGUST 31, 1994... | 2,987,154 | \$ 298,715 | \$17,007,158 | \$(13,125,080) | \$ 4,180,793 |
| Sale of common stock, net of offering expenses of \$1,033,118..... | 1,979,499 | 197,950 | 11,098,880 | -- | 11,296,830 |
| Issuance of common stock as employee compensation and for other obligations.... | 450,378 | 45,038 | 1,684,840 | -- | 1,729,878 |
| Net loss..... | -- | -- | -- | (7,599,611) | (7,599,611) |
| | ----- | ----- | ----- | ----- | ----- |
| BALANCE, AUGUST 31, 1995... | 5,417,031 | \$ 541,703 | \$29,790,878 | \$(20,724,691) | \$ 9,607,890 |
| | ===== | ===== | ===== | ===== | ===== |
| Sale of common stock, net of offering expenses of \$1,539,646..... | 2,500,000 | 250,000 | 20,710,354 | -- | 20,960,354 |
| Issuance of common stock for purchase of interests in oil and gas ventures..... | 225,000 | 22,500 | 2,330,625 | -- | 2,353,125 |
| Issuance of common stock upon conversion of debentures..... | 498,662 | 49,866 | 3,884,472 | -- | 3,934,338 |
| Issuance of common stock upon exercise of warrants and options..... | 47,611 | 4,761 | 138,074 | -- | 142,835 |
| Net loss..... | -- | -- | -- | (6,493,552) | (6,493,552) |
| | ----- | ----- | ----- | ----- | ----- |
| BALANCE, AUGUST 31, 1996... | 8,688,304 | \$ 868,830 | \$56,854,403 | \$(27,218,243) | \$ 30,504,990 |
| | ===== | ===== | ===== | ===== | ===== |
| Issuance of common stock upon conversion of debentures..... | 29,563 | 2,956 | 277,438 | -- | 280,394 |
| Issuance of common stock upon exercise of warrants and options..... | 2,366,377 | 236,638 | 24,827,704 | -- | 25,064,342 |
| Net loss..... | -- | -- | -- | (2,604,455) | (2,604,455) |
| | ----- | ----- | ----- | ----- | ----- |
| BALANCE, DECEMBER 31, 1996..... | 11,084,244 | \$1,108,424 | \$81,959,545 | \$(29,822,698) | \$ 53,245,271 |

| | ===== | ===== | ===== | ===== | ===== |
|---|------------|-------------|--------------|----------------|---------------|
| Issuance of common stock for purchase of interest in oil and gas venture... | 87,500 | 8,750 | 1,052,186 | -- | 1,060,936 |
| Issuance of common stock upon exercise of warrants and options..... | 52,000 | 5,200 | 150,800 | -- | 156,000 |
| Net loss..... | -- | -- | -- | (27,682,951) | (27,682,951) |
| | ----- | ----- | ----- | ----- | ----- |
| BALANCE, DECEMBER 31, 1997..... | 11,223,744 | \$1,122,374 | \$83,162,531 | \$(57,505,649) | \$ 26,779,256 |
| | ===== | ===== | ===== | ===== | ===== |

</TABLE>

The accompanying notes are an integral part of the consolidated financial
statements

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CANARGO ENERGY CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1997 AND
AUGUST 31, 1996 AND 1995

<TABLE>

<CAPTION>

| | 1997 | 1996 | 1995 |
|--|----------------|---------------|---------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Operating activities: | | | |
| Net loss..... | \$(27,682,951) | \$(6,493,552) | \$(7,599,611) |
| Depreciation and amortization..... | 344,666 | 77,253 | 1,156,772 |
| Gain on settlement of liabilities..... | -- | -- | (58,230) |
| Loss on disposition of equipment and property..... | 271,205 | 182,020 | -- |
| Impairment of notes receivable..... | 186,611 | -- | -- |
| Impairment of property and equipment..... | 3,243,997 | -- | 175,450 |
| Impairment of intangibles..... | -- | -- | 1,924,202 |
| Impairment of oil and gas properties..... | 257,407 | 419,835 | 608,181 |
| Impairment of oil and gas ventures..... | 15,735,592 | -- | -- |
| Issuance of common stock for services and expenses..... | -- | -- | 1,482,664 |
| Amortization of debt issuance costs and discount..... | -- | 866,666 | -- |
| Loss in investments in unconsolidated subsidiaries..... | 3,778,287 | 13,272 | -- |
| Minority interest in loss of unconsolidated subsidiary..... | (205,380) | -- | -- |
| Changes in assets and liabilities: | | | |
| Accounts receivable..... | 259,040 | 53,905 | 65,977 |
| Other assets..... | (139,493) | (211,222) | (325,289) |
| Accounts payable..... | (471,814) | 62,638 | 394,784 |
| Accrued liabilities..... | 246,920 | (116,766) | 217,022 |
| | ----- | ----- | ----- |
| NET CASH USED IN OPERATING ACTIVITIES..... | (4,175,913) | (5,145,951) | (1,958,078) |
| | ----- | ----- | ----- |
| Investing activities: | | | |
| Restricted cash..... | (4,300,000) | -- | -- |
| Investments in oil and gas properties..... | (1,318,492) | (155,938) | (2,458,596) |
| Investments in and advances to oil and gas ventures..... | (6,280,613) | (2,644,837) | -- |
| Capital expenditures..... | (1,573,507) | (3,728,770) | (404,822) |
| Proceeds from disposition of assets..... | 232,638 | 104,000 | -- |

| | | | |
|--|---------------|--------------|--------------|
| Issuance of notes receivable..... | -- | (135,186) | (2,980,000) |
| NET CASH USED IN INVESTING ACTIVITIES..... | (13,239,974) | (6,560,731) | (5,843,418) |
| Financing activities: | | | |
| Proceeds from issuance of debentures, net of expenses..... | -- | 3,346,723 | -- |
| Proceeds from sales of common stock, net of expenses..... | -- | 21,103,189 | 11,296,830 |
| Proceeds from exercise of options..... | 156,000 | -- | -- |
| Proceeds from issuance of short-term borrowings... | -- | 4,848,476 | 47,813 |
| Principal payments on short-term borrowings..... | -- | (5,054,114) | (271,563) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES..... | 156,000 | 24,244,274 | 11,073,080 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... | (17,259,887) | 12,537,592 | 3,271,584 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR..... | 31,424,064 | 4,791,645 | 1,520,061 |
| CASH AND CASH EQUIVALENTS, END OF YEAR..... | \$ 14,164,177 | \$17,329,237 | \$ 4,791,645 |
| | ===== | ===== | ===== |

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements

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CANARGO ENERGY CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS -- CONTINUED

FOR THE FOUR MONTH PERIODS ENDED DECEMBER 31, 1996 AND 1995

<TABLE>

<CAPTION>

| | 1996 | 1995 |
|---|---------------|---------------|
| | ----- | ----- |
| | | (UNAUDITED) |
| <S> | <C> | <C> |
| Operating activities: | | |
| Net loss..... | \$(2,604,455) | \$(1,442,182) |
| Depreciation and amortization..... | 39,578 | 43,643 |
| Amortization of debt issuance costs and discount..... | 1,375 | -- |
| Loss in investments in unconsolidated subsidiaries..... | 1,359,246 | 4,424 |
| Minority interest in loss of unconsolidated subsidiary..... | (17,970) | -- |
| Changes in assets and liabilities: | | |
| Accounts receivable..... | (251,828) | (114,236) |
| Other assets..... | 26,687 | 88,344 |
| Accounts payable..... | 68,453 | (305,580) |
| Accrued liabilities..... | 149,069 | (242,037) |
| NET CASH USED IN OPERATING ACTIVITIES..... | (1,229,845) | (1,967,624) |
| Investing activities: | | |
| Restricted cash..... | (5,400,000) | -- |
| Investments in and advances to oil and gas ventures..... | (3,108,472) | (1,369,767) |
| Capital expenditures..... | (1,200,042) | (746,810) |
| Proceeds from disposition of assets..... | -- | (73,900) |
| | ----- | ----- |

| | | |
|--|--------------|-------------|
| NET CASH USED IN INVESTING ACTIVITIES..... | (9,708,514) | (2,190,477) |
| | ----- | ----- |
| Financing activities: | | |
| Proceeds from exercise of warrants and options.... | 25,064,342 | -- |
| Proceeds from issuance of short-term borrowings... | -- | 122,153 |
| Principal payments on short-term borrowings..... | (31,156) | (25,108) |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES..... | 25,033,186 | 97,045 |
| | ----- | ----- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... | 14,094,827 | (4,061,056) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR..... | 17,329,237 | 4,791,645 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, END OF YEAR..... | \$31,424,064 | \$ 730,589 |
| | ===== | ===== |

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

On July 15, 1998, the Company completed the purchase of CanArgo Energy, described below, changed its name to CanArgo Energy Corporation and effected a one-for-two reverse split of its common stock. The reverse split has been reflected retroactively in the accompanying financial statements.

The principal activities of CanArgo Energy Corporation and its consolidated subsidiaries (collectively the "Company") have involved the acquisition of interests in and development of oil and gas fields with a productive history that indicate the potential for increased production through rehabilitation and utilization of modern production techniques and enhanced oil recovery processes. The Company has typically acquired its interests in oil and gas properties through interests in joint ventures, partially owned corporate and other entities, and joint operating arrangements. While the Company has acquired interests representing 50% or less of the equity in various oil and gas projects, it has generally sought operational responsibility for the substantial oil and gas projects in which it has interests. Accordingly, certain of the activities in which the Company has interests are conducted through unconsolidated entities. The Company has acquired less than majority interests in entities developing or seeking to develop oil and gas properties in Eastern Europe including the Russian Federation. These entities are accounted for as unconsolidated subsidiaries.

On February 2, 1998, the Company entered into a Combination Agreement with CanArgo Energy Inc. ("CanArgo") pursuant to which CanArgo would become a subsidiary of the Company and each of the outstanding CanArgo Common Shares would be converted into the right to receive 1.6 shares of the Company's Common Stock. Consummation of the business combination is subject to satisfaction of a number of conditions, including approvals by the stockholders of the Company and the shareholders of CanArgo. It is expected that following the business combination the former shareholders of CanArgo would have the right to receive approximately 47% of the Company's Common Stock. The business combination could result in a change in the Company's ownership as defined in Section 382 of the Internal Revenue Code. See Note 13, Income Taxes, of Notes to Consolidated Financial Statements. Upon consummation of the business combination, current management of CanArgo will hold a majority of the Company's management positions.

The Company elected to change its fiscal year from August 31 to December 31 effective December 31, 1996 in order to conform to the calendar year accounting which is required for most of the significant oil and gas projects in which the Company participates. Accordingly, the accompanying consolidated financial statements include information for the four-month transition period ended December 31, 1996. The comparable statements of operations and cash flows for the four month period ended December 31, 1995 and all related footnote disclosures are unaudited. Such unaudited information includes all adjustments necessary in the opinion of the management of the Company for a fair statement of the results of operations and cash flows. Results for the four month period may not be indicative of results for the full year.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION -- The financial statements and notes thereto are prepared in accordance with U.S. generally accepted accounting principles. All amounts are in U.S. dollars.

CONSOLIDATION -- The consolidated financial statements include the accounts of CanArgo Energy Corporation and its majority owned subsidiaries. The majority owned subsidiaries at December 31, 1997 are Electromagnetic Oil Recovery International Inc., Focan Ltd., Fountain Oil Adygea Incorporated, Fountain Oil Boryslaw Incorporated, Fountain Oil Boryslaw Ltd., Fountain Oil Norway AS, Fountain Oil Production Incorporated, Fountain Oil Services Ltd., Fountain Oil Ukraine Ltd., Fountain Oil U.S. Inc., Gastron International Limited, Uentech Corporation and UK-RAN Oil Corporation. All significant intercompany transactions and accounts have been eliminated. The Company's investments in certain oil and gas ventures are proportionately consolidated. Investments in less than majority-owned corporations and corporate-like entities are accounted for using the equity method of accounting.

QUASI-REORGANIZATION -- The Board of Directors of the Company approved a quasi-reorganization effective October 31, 1988. As of the date of the quasi-reorganization, the accumulated deficit of \$39,952,292 was eliminated against capital in excess of par value.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS -- The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECLASSIFICATION -- Certain items in the consolidated financial statements have been reclassified to conform to the current year presentation. There was no effect on net loss as a result of these reclassifications.

CASH AND CASH EQUIVALENTS -- The Company considers unrestricted short-term, highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents.

INVESTMENTS -- The Company's investments in cash equivalents are classified as held to maturity and are carried at amortized cost which approximates fair value due to their short-term nature.

PROPERTY AND EQUIPMENT -- Property and equipment is stated at cost unless the carrying amount is viewed as not recoverable in which case the carrying value of

the assets is reduced to the estimated recoverable amount. See "Impairment of Long-Lived Assets" below. Expenditures for major renewals and betterments, which extend the original estimated economic useful lives of applicable assets, are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and any gain or loss thereon is reflected in operations. Depreciation of property and equipment is

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

computed using the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

OIL AND GAS PROPERTIES -- The Company and the unconsolidated entities for which it accounts using the equity method account for oil and gas properties and interests under the full cost method. Under this accounting method, costs, including a portion of internal costs associated with property acquisition and exploration for and development of oil and gas reserves, are capitalized within cost centers established on a country-by-country basis. Capitalized costs within a cost center, as well as the estimated future expenditures to develop proved reserves and estimated net costs of dismantlement and abandonment, are amortized using the unit-of-production method based on estimated proved oil and gas reserves. All costs relating to production activities are charged to expense as incurred.

Capitalized oil and gas property costs, less accumulated depreciation, depletion and amortization and related deferred income taxes, are limited to an amount (the ceiling limitation) equal to (a) the present value (discounted at 10%) of estimated future net revenues from the projected production of proved oil and gas reserves, calculated at prices in effect as of the balance sheet date (with consideration of price changes only to the extent provided by fixed and determinable contractual arrangements), plus (b) the lower of cost or estimated fair value of unproved and unevaluated properties, less (c) income tax effects related to differences in the book and tax basis of the oil and gas properties.

REVENUE RECOGNITION -- The Company recognizes revenues when goods have been delivered, when services have been performed, or when hydrocarbons have been produced and delivered.

FOREIGN CURRENCY TRANSLATION -- The U.S. dollar is the functional currency for all of the Company's operations. Accordingly, all monetary assets and liabilities denominated in foreign currency are translated into U.S. dollars at the rate of exchange in effect at the balance sheet date and the resulting unrealized translation gains or losses are reflected in operations. Non-monetary assets are translated at historical exchange rates. Revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange for the year. Foreign currency translation amounts recorded in operations for years ended December 31, 1997 and August 31, 1996 and the four months ended December 31, 1996 and 1995 were not material.

INCOME TAXES -- The Company follows the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and the tax bases of assets and liabilities using enacted rates in effect for the years in which the differences are expected to reverse. Valuation allowances are established, when appropriate, to reduce deferred tax assets to the amount

expected to be realized.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

IMPAIRMENT OF LONG-LIVED ASSETS -- The Company reviews all of its long-lived assets, except for its oil and gas assets, for impairment in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, Accounting for the Impairment of Long-Lived Assets and Assets to be Disposed Of. Prior to the adoption of SFAS No. 121, all long-lived assets including intangible assets, other than oil and gas properties, were reviewed for impairment by comparing the carrying value of such assets to future expected net cash flows undiscounted. The Company evaluates its oil and gas properties and its carrying value of investments in unconsolidated entities conducting oil and gas operations in accordance with the full cost ceiling limitation.

STOCK-BASED COMPENSATION PLANS -- The Company has adopted only the disclosure requirements of SFAS No. 123, Accounting for Stock-Based Compensation, and has elected to continue to record stock-based compensation expense using the intrinsic-value approach prescribed by Accounting Principles Board ("APB") Opinion 25. Accordingly, the Company computes compensation cost for each employee stock option granted as the amount by which the quoted market price of the Company's Common Stock on the date of grant exceeds the amount the employee must pay to acquire the stock. The amount of compensation costs, if any, is charged to operations over the vesting period.

RECENTLY ISSUED PRONOUNCEMENTS -- In 1997, the Financial Accounting Standards Board issued SFAS No. 130, Reporting Comprehensive Income, and SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, both of which have been adopted in the fourth quarter of 1997 without having any material effect on the Company's financial statements.

3. GOING CONCERN ASSUMPTION

The Company has incurred recurring operating losses, and its current operations are not generating positive cash flows. The ability of the Company to continue as a going concern and to pursue its principal activities of acquiring interest in and developing oil and gas fields is highly dependent upon generating funds from external sources and, ultimately, achieving sufficient positive cash flows from operating activities.

Without sufficient cash from external sources, the Company's ability to finance its ongoing operations and continue as a going concern is doubtful. However, the Company's management believes that it may be able to access external sources of funds through a merger or other business combination with another company followed by equity or debt financing by the surviving entity or by the farm out of interests in certain oil and gas projects. See Note 6, Oil and Gas Properties and Investments, of Notes to Consolidated Financial Statements.

The consolidated financial statements do not give effect to any additional impairment of its investments in oil and gas ventures or other adjustments which would be necessary should the Company be unable to obtain sufficient funds from external sources or continue as a going concern.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

4. RESTRICTED CASH

Through December 31, 1997 and 1996, the Company has pledged an aggregate of \$9,700,000 and \$5,400,000, respectively, to collateralize bank letters of credit. Letters of credit supported by the restricted cash have been used primarily to assure repayment of borrowings under a line of credit established by Kashtan Petroleum Ltd. ("Kashtan"), which operates the Lelyaki Field project, under which \$8,150,000 and \$1,400,000 was outstanding at December 31, 1997 and 1996, respectively. Kashtan has utilized such borrowings to pay Lelyaki Field project operating costs, including repayment of costs advanced by the Company on behalf of Kashtan. If beneficiaries of such collateralized bank letters of credit were to draw on the letters of credit as a result of non-performance by ventures of their obligations to the beneficiaries or otherwise, the banks would, in turn, draw against the restricted cash to reimburse themselves for amounts paid on the letters of credit. Based on its analysis of initial Lelyaki Field development efforts, the Company has concluded that the Lelyaki Field will not support a successful commercial development. As a result, the Company has written off any remaining investments relating to the Lelyaki Field project and has accrued a liability of \$8,280,000 with respect to Kashtan indebtedness supported by the Company's restricted cash deposits. The liability is included within accrued liabilities on the Company's balance sheet as of December 31, 1997. See Note 6, Oil and Gas Properties and Investments, of Notes to Consolidated Financial Statements.

5. PROPERTY AND EQUIPMENT, NET

Property and equipment and the related accumulated depreciation at December 31, 1997 included the following:

<TABLE>
<CAPTION>

| | COST | ACCUMULATED DEPRECIATION | IMPAIRMENT | NET |
|--|-------------|-----------------------------|---------------|-------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| EEOR equipment..... | \$ 562,953 | \$(284,909) | \$ -- | \$ 278,044 |
| Oil and gas related equipment..... | 8,348,309 | -- | (2,843,997) | 5,504,312 |
| Office furniture, fixtures and equipment and other..... | 1,014,263 | (454,346) | (400,000) | 159,917 |
| | ----- | ----- | ----- | ----- |
| Property and Equipment, net... | \$9,925,525 | \$(739,255) | \$(3,243,997) | \$5,942,273 |
| | ===== | ===== | ===== | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

5. PROPERTY AND EQUIPMENT, NET -- (CONTINUED)

Property and equipment and the related accumulated depreciation at December 31, 1996 included the following:

<TABLE>
<CAPTION>

| | COST | ACCUMULATED DEPRECIATION | IMPAIRMENT | NET |
|---------------------------------------|------------|-----------------------------|------------|------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| EEOR equipment..... | \$ 504,085 | \$(273,673) | \$ -- | \$ 230,412 |
| EEOR construction-in-progress.... | 60,764 | -- | -- | 60,764 |
| Oil and gas related equipment..... | 6,956,709 | -- | -- | 6,956,709 |

| | | | | |
|---|-------------|-------------|-------|-------------|
| Office furniture, fixtures and equipment and other..... | 850,031 | (331,437) | -- | 518,594 |
| | ----- | ----- | ----- | ----- |
| Property and Equipment, net... | \$8,371,589 | \$(605,110) | \$ -- | \$7,766,479 |
| | ===== | ===== | ===== | ===== |

</TABLE>

Property and equipment and the related accumulated depreciation at August 31, 1996 included the following:

<TABLE>

<CAPTION>

| | COST | ACCUMULATED DEPRECIATION | IMPAIRMENT | NET |
|---|-------------|-----------------------------|------------|-------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| EEOR equipment..... | \$ 504,085 | \$(268,011) | \$ -- | \$ 236,074 |
| EEOR | | | | |
| construction-in-progress.... | 60,764 | -- | -- | 60,764 |
| Oil and gas related | | | | |
| equipment..... | 5,818,871 | -- | -- | 5,818,871 |
| Office furniture, fixtures and equipment and other..... | 759,448 | (297,592) | -- | 461,856 |
| | ----- | ----- | ----- | ----- |
| Property and Equipment, net... | \$7,143,168 | \$(565,603) | \$ -- | \$6,577,565 |
| | ===== | ===== | ===== | ===== |

</TABLE>

Oil and gas related equipment includes new or refurbished drilling rigs and related equipment including lease and well equipment which the Company originally planned to transfer to Intergas JSC ("Intergas"), an entity in which the Company holds a 37% interest, to use in the Maykop Field, Republic of Adygea, Russian Federation. Such rigs and equipment have not yet been placed in service and therefore are not being depreciated. Because it has experienced extended delays in resolving operating arrangements and other Intergas matters including corporate formalities, the Company has concluded that under present circumstances it cannot pursue commercial activities and develop the Maykop Field through Intergas. As a result, the Company has written off its investment in and advances to Intergas at December 31, 1997. See Note 6, Oil and Gas Properties and Investments, of Notes to Consolidated Financial Statements. Since the rigs and equipment are now expected to be employed for application other than those for which they were specifically intended, the Company recorded an impairment of \$2,844,000 at December 31, 1997, which represents the difference between the book value of the rigs and related equipment and their estimated fair value.

As a result of the Company's decision to close down or significantly reduce its various corporate offices, the Company recorded an impairment of \$400,000 to reduce the carrying value of furniture, fixtures and equipment to their estimated fair value.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS

OIL AND GAS PROPERTIES

The Company has acquired interests in oil and gas properties through joint ventures and other joint operating arrangements. A summary of the Company's oil and gas properties as of December 31, 1997 and 1996 and August 31, 1996 are set out below:

<TABLE>
<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|---|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Oil and Gas Properties | | | |
| United States and Canada | | | |
| Proved properties..... | \$ 2,650,327 | \$ 1,029,947 | \$ 1,058,397 |
| Unproved properties..... | 324,500 | 257,407 | 257,407 |
| Less: accumulated depreciation, depletion, amortization and impairment..... | (1,495,853) | (1,028,016) | (1,028,016) |
| | ----- | ----- | ----- |
| Total Oil and Gas Properties, net..... | \$ 1,478,974 | \$ 259,338 | \$ 287,788 |
| | ===== | ===== | ===== |

</TABLE>

During the fiscal years ended December 31, 1997 and August 31, 1996, the Company recognized impairments of \$257,407 and \$419,835 respectively, on its oil and gas properties as a result of applying the full cost ceiling limitation. The impairments related to previously unproved properties.

During the first quarter of 1997, the Company purchased a 60% interest in a heavy oil property in the Sylvan Lake area in Alberta, Canada for approximately \$1,009,000. One new well was successfully drilled during the 1997 third quarter, and was prepared for installation of the Company's electrically enhanced oil recovery ("EOR") equipment. The Sylvan Lake project includes a total of four producing wells.

Unproved properties and associated costs not currently being amortized and included in oil and gas properties in Canada at December 31, 1997 were \$324,500, substantially all of which relates to the Sylvan Lake Field. Such properties are expected to be evaluated over the next 24 months, and if no proved reserves are added, those properties could result in additional impairment.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS -- (CONTINUED) INVESTMENTS

The Company has acquired interests in oil and gas ventures through less than majority interests in corporate and corporate-like entities. A summary of the Company's oil and gas ventures as of December 31, 1997 and 1996 and August 31, 1996 is set out below:

<TABLE>
<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|--|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Investments in and Advances to Oil and Gas Ventures | | | |
| Ukraine -- Lelyaki Field, Pryluki Region | | | |
| through an effective 40.5% ownership of Kashtan Petroleum Ltd..... | \$ 2,435,725 | \$2,398,566 | \$2,163,564 |
| Adygea, Russian Federation -- Maykop | | | |

| | | | |
|--|--------------|-------------|-------------|
| Field | | | |
| through 37% ownership in Intergas JSC..... | 6,710,874 | 4,439,213 | 2,780,263 |
| Canada -- Inverness Unit | | | |
| through 50% ownership in Focan Ltd..... | -- | 106,646 | 106,646 |
| Albania -- Gorisht-Kocul Field | | | |
| through 50% ownership of the joint venture..... | 2,202,922 | 1,326,581 | 517,885 |
| Ukraine -- Stynawske Field, Boryslaw | | | |
| through 45% ownership of Boryslaw Oil Company..... | 5,800,407 | 1,655,803 | 1,321,241 |
| | ----- | ----- | ----- |
| Total Investments in and Advances to Oil and Gas Ventures..... | \$17,149,928 | \$9,926,809 | \$6,889,599 |
| | ===== | ===== | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS -- (CONTINUED)

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|---|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Equity in Profit (Loss) of Oil and Gas Ventures | | | |
| Ukraine -- Lelyaki Field, Pryluki Region..... | \$(2,435,725) | \$ (355,684) | \$ -- |
| Adygea, Russian Federation -- Maykop Field..... | (1,452,510) | (601,366) | -- |
| Canada -- Inverness Unit..... | -- | (2,407) | (13,272) |
| Albania -- Gorisht-Kocul Field..... | (833,191) | (399,789) | -- |
| Ukraine -- Stynawske Field, Boryslaw... | (413,700) | -- | -- |
| | ----- | ----- | ----- |
| Cumulative Equity in Profit (Loss) of Oil and Gas Ventures..... | \$(5,135,126) | \$(1,359,246) | \$ (13,272) |
| | ===== | ===== | ===== |
| Impairment -- Maykop Field..... | \$(5,258,364) | \$ -- | \$ -- |
| Impairment -- Gorisht-Kocul Field..... | (1,369,731) | -- | -- |
| | ----- | ----- | ----- |
| Total impairment..... | \$(6,628,095) | \$ -- | \$ -- |
| | ===== | ===== | ===== |
| Total Investments in and Advances to Oil and Gas Ventures, Net of Equity Loss and Impairment..... | \$ 5,386,707 | \$ 8,567,563 | \$6,876,327 |
| | ===== | ===== | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS -- (CONTINUED)

The following supplemental information relates to the Company's investment in and advances to its two most significant oil and gas ventures:

<TABLE>
<CAPTION>

| | YEAR ENDED DECEMBER 31, 1997 | FOUR MONTHS ENDED DECEMBER 31, 1996 | YEAR ENDED AUGUST 31, 1996 | YEAR ENDED AUGUST 31, 1995 |
|--|------------------------------------|--|----------------------------------|----------------------------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| Total funding from owners: | | | | |
| Kashtan..... | \$ 304,508 | \$ -- | \$303,472 | \$ -- |
| Intergas..... | 2,529,292 | 609,780 | 963,949 | 174,564 |
| Total cash expenditures by the venture: | | | | |
| Kashtan..... | \$7,275,440 | (1) | (1) | \$ -- |
| Intergas..... | 2,529,292 | 609,780 | 963,949 | 174,564 |

<CAPTION>

| | TANGIBLE ASSETS | LIABILITIES |
|---|--------------------|----------------|
| | ----- | ----- |
| Tangible assets and liabilities at December 31, 1997: | | |
| Kashtan..... | \$ 943,830 | \$8,315,811(2) |
| Intergas..... | 26,906 | -- |

</TABLE>

(1) For the period from inception, December 8, 1995 through December 31, 1996, total cash expenditures by Kashtan amounted to \$1,475,254.

(2) See Note 4, Restricted Cash, of Notes to Consolidated Financial Statements regarding Kashtan's indebtedness supported by the Company's restricted cash deposits.

During the fourth quarter of 1997, the Company recognized impairment losses totaling \$15,736,000 related to the Lelyaki Field, Maykop Field and Gorisht-Kocul Field projects. In addition, aggregate losses of \$3,365,000 were recorded in 1997 reflecting the Company's equity in the losses of Kashtan, Intergas and the Gorisht-Kocul joint venture.

Based on its analysis of initial Lelyaki Field development efforts completed in the fourth quarter of 1997, the Company concluded that the Lelyaki Field will not support a successful commercial development. As a result, the Company recorded an impairment charge totaling \$9,108,000. The impairment charge consisted of \$137,000 which represented the carrying value of an investment related to Kashtan, \$8,280,000 of debt and accrued interest of Kashtan on which Kashtan has defaulted or is expected to default and which was effectively guaranteed by the Company through restricted cash deposits, and \$691,000 of estimated liabilities for severance and related costs associated with closing down Kashtan's operations. Such costs are expected to be paid during 1998. In addition, the Company recognized a loss in 1997 of \$2,080,000 reflecting its equity in the loss of Kashtan. The Company believes that it has no further obligation to fund operations of Kashtan.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS -- (CONTINUED)

Because it has experienced extended delays in resolving operating arrangements and other Intergas matters including completion of corporate formalities, the

Company has concluded that under present circumstances it cannot pursue commercial activities and develop the Maykop Field through Intergas. As a result, the Company during the fourth quarter of 1997 recorded an impairment for the entire amount of its investment in and advances to Intergas of \$5,258,000. In addition, the Company recognized a loss in 1997 of \$851,000, reflecting its equity in the loss of Intergas. The Company believes that it has no further obligation to fund operations of Intergas.

In March 1997, the Company declared the political unrest in Albania to be a force majeure with respect to the Gorisht-Kocul project, and development activities related thereto have been suspended since the declaration. In light of the extended period that the force majeure condition has continued and in the absence of any indication of an imminent termination of that condition, the Company during the fourth quarter of 1997 recorded an impairment for the entire amount of its investment in and advances to the Gorisht-Kocul joint venture of \$1,370,000. The Company also recognized a \$433,000 loss in 1997 as its equity in the loss of that joint venture.

The Company has made advances to Boryslaw Oil Company totaling \$1,508,000 at December 31, 1997, which are included within investments in and advances to oil and gas ventures. Such advances may be recoverable only from future revenue of or payments from future participants in the venture.

Since none of the Company's oil and gas interests outside of Canada are being amortized, the Company's investments in and advances to oil and gas ventures are essentially unevaluated properties. At December 31, 1997, there were no material operations or assets (other than unevaluated properties) of entities being accounted for using the equity method. Accordingly, no separate financial information has been presented.

As a result of the events associated with the impairment of the Company's investment in and advances to and other assets related to Kashtan, Intergas and the Gorisht-Kocul joint venture, the Company may be subject to contingent liabilities in the form of claims from those ventures and other participants therein. Fountain has been advised that Intergas and another shareholders of Intergas are considering asserting such claims. Management is unable to estimate the range that such claims, if any, might total. However, if any claims were determined to be valid, they could have a material adverse effect on the financial position, results of operations and cash flows of the Company.

Development of the oil and gas properties and ventures in which the Company has interests involves multi-year efforts and substantial cash expenditures. The Company had working capital of \$13,971,000 at December 31, 1997, which it considered inadequate to proceed with full implementation of its program of developing its principal oil and gas properties and ventures. Full development of these properties and ventures would require the availability of substantial funds from external sources. The Company believes that its ability to access external financing is dependent upon the successful completion of a business combination with, or the farm-out of a significant portion of its interest in Boryslaw Oil Company and possibly other projects to an entity that can provide or attract

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. OIL AND GAS PROPERTIES AND INVESTMENTS -- (CONTINUED)

such financing. The Company generally has the principal responsibility for arranging financing for the oil and gas properties and ventures in which it has an interest. There can be no assurance, however, that the Company or the entities that are developing the oil and gas properties and ventures will be able to arrange the financing necessary to develop the projects being undertaken or to support the corporate and other activities of the Company or that such

financing as is available will be on terms that are attractive or acceptable to or are deemed to be in the best interests of the Company, such entities or their respective stockholders or participants.

As of December 31, 1997 the Company had remaining net investments in oil and gas properties and ventures totaling \$6,866,000. Of this amount, \$5,387,000 relates to a venture in Eastern Europe for which development operations have not yet begun. Ultimate realization of the carrying value of the Company's oil and gas properties and ventures will require production of oil and gas in sufficient quantities and marketing such oil and gas at sufficient prices to provide positive cash flow to the Company, which is dependent upon, among other factors, achieving significant production at costs that provide acceptable margins, reasonable levels of taxation from local authorities, and the ability to market the oil and gas produced at or near world prices. In addition, the Company must mobilize drilling equipment and personnel to initiate drilling, completion and production activities. The Company has plans to mobilize resources and achieve levels of production and profits sufficient to recover its carrying value. However, if one or more of the above factors, or other factors, are different than anticipated, these plans may not be realized, and the Company may not recover its carrying value. The Company will be entitled to distributions from the various properties and ventures in accordance with the arrangements governing the respective properties and ventures.

The consolidated financial statements of the Company do not give effect to any additional impairment in the value of the Company's investment in oil and gas properties and ventures or other adjustments that would be necessary if financing cannot be arranged for the development of such properties and ventures or if they are unable to achieve profitable operations. The Company's consolidated financial statements have been prepared under the assumption of a going concern. Failure to arrange such financing on reasonable terms or failure of such properties and ventures to achieve profitability would have a material adverse effect on the financial position, including realization of assets, results of operations, cash flows and prospects of the Company and ultimately its ability to continue as a going concern.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

7. ACCRUED LIABILITIES

Accrued liabilities at December 31, 1997, December 31, 1996 and August 31, 1996 included the following:

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|--|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Compensation, including related taxes... | \$ 337,767 | \$ 225,409 | \$209,283 |
| Professional fees..... | 276,500 | 104,150 | -- |
| Termination costs..... | 405,833 | -- | -- |
| Effective guarantee of Kashtan obligations (Note 6)..... | 8,280,000 | -- | -- |
| Close down costs -- Kashtan project (Note 6)..... | 690,622 | -- | -- |
| Oilfield related equipment..... | 268,000 | 677,843 | -- |
| Other..... | 67,886 | 117,023 | 88,230 |
| | ----- | ----- | ----- |
| | \$10,326,608 | \$1,124,425 | \$297,513 |
| | ===== | ===== | ===== |

</TABLE>

The accrual for termination costs represents the amount of costs for employees receiving contractually required termination notices during the fourth quarter of 1997. The costs involved represent salaries and related taxes and have been reflected as general and administrative expenses. The accrual includes the termination costs for 11 employees, who were located in the Company's offices in Calgary and Asker, Norway. Such costs are expected to be paid during 1998.

8. CONVERTIBLE SUBORDINATED DEBENTURES

During the quarter ended February 29, 1996, the Company completed an offering of its 8% Convertible Subordinated Debentures (the "Debentures") due December 31, 1997. The Company issued \$3,750,000 principal amount of Debentures at par and received net proceeds of \$3,346,723 after commissions and expenses. The Debentures were convertible into shares of the Company's Common Stock at a price equal to 82 1/2% of the average closing price of such shares on the five trading days preceding the date of conversion. A maximum of 154,750 shares of the Company's Common Stock was issuable upon conversion of each \$1,000,000 principal amount of the Debentures. At August 31, 1996, \$3,450,000 principal amount of the Debentures had been converted into 498,662 shares of Common Stock. During the four months ended December 31, 1996, the remaining \$300,000 principal amount of Debentures was converted into 29,563 shares of Common Stock.

In accordance with Securities and Exchange Commission guidance published in early 1997, the August 31, 1996 Consolidated Statement of Operations was restated to reflect a \$795,500 charge to interest expense related to the discount feature of the Debentures. The discount was amortized from the date of issuance to the earliest conversion dates.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

9. COMMITMENTS AND CONTINGENCIES

OIL AND GAS PROPERTIES AND INVESTMENTS IN OIL AND GAS VENTURES -- The Company has contingent obligations and may incur additional obligations, absolute and contingent, with respect to acquiring and developing oil and gas properties and ventures. At December 31, 1997, the Company had the contingent obligation to issue an aggregate of 187,500 shares of its Common Stock, subject to the satisfaction of conditions related to the achievement of specified performance standards by the Stynawske Field project. The Company believes that it has no further obligation to fund operations of Kashtan or Intergas. Also see Note 6, Oil and Gas Properties and Investments, of Notes to Consolidated Financial Statements.

LEGAL PROCEEDINGS AND POTENTIAL CLAIMS -- On February 20, 1998, Zhoda Corporation ("Zhoda"), which sold to Fountain most of Fountain's interest in UK-RAN, filed suit against Fountain and two of its consolidated subsidiaries in the District Court of Harris County, Texas. Zhoda alleges that Zhoda was, on several theories, wrongfully deprived of the value of the UK-RAN shares it transferred to Fountain or the contingent consideration it might have received under its agreement with Fountain. Among the theories of Zhoda's complaint are breach of contract, breach of fiduciary duty and duty of good faith and fair dealing, fraud and constructive fraud, fraud in the inducement, negligent misrepresentation, civil conspiracy, breach of trust, unjust enrichment and rescission. Zhoda seeks damages in excess of \$7.5 million, redelivery of the UK-RAN shares transferred to Fountain, fees, expenses and costs and any further relief to which it may be entitled.

On March 9, 1998, Ribalta Holdings, Inc. ("Ribalta"), which sold to Fountain the outstanding capital of Gastron International Limited ("Gastron"), which in turn owned 31% of the capital of Intergas, filed suit against Fountain and one of its

consolidated subsidiaries in the Third Judicial District Court of Salt Lake County, Utah. In its complaint, Ribalta alleges breach by Fountain of the contract governing the sale of the outstanding capital of Gastron and failure of a condition in that contract that should have resulted in its termination. Ribalta seeks the return of all benefits conferred on Fountain pursuant to the contract, including the shares of Gastron and any property transferred by Gastron, or, alternatively, damages equal to the value of such benefits, as well as fees, costs and such other relief as the court deems proper.

The entity that sold to Fountain certain rights related to the Stynawske Field project has indicated to Fountain that it is considering an action seeking the contingent consideration payable with respect to that sale on the grounds that the Transaction or other action by or inaction of Fountain has unreasonably delayed or will unreasonably delay the satisfaction of the conditions precedent to the issuance of such contingent consideration.

As a result of the events associated with the impairment of Fountain's investment in and advances to and other assets related to Kashtan, Intergas and the Gorisht-Kocul joint venture, the Company may be subject to contingent liabilities in the form of claims from those ventures and other participants therein. Fountain has been advised that Intergas and another shareholder of Intergas are considering asserting such claims.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

9. COMMITMENTS AND CONTINGENCIES -- (CONTINUED)

Management is unable to estimate the range that such potential claims, if any, might total. However, if any asserted claims were determined to be valid, they could have a material adverse effect on the financial position, results of operations and cash flows of the Company.

LEASE COMMITMENTS -- The Company leases office space under non-cancellable operating lease agreements. The leases have remaining terms ranging up to eight years, some of which may be renewed at the Company's option. Rental expense for the years ended December 31, 1997 and August 31, 1996 and 1995 and for the four months ended December 31, 1996 was \$293,855, \$186,444, \$119,133 and \$87,872, respectively.

Future minimum rental payments for the Company's lease obligations as of December 31, 1997, are as follows:

<TABLE>

| <S> | <C> |
|------------------|-------------|
| 1998..... | \$ 388,235 |
| 1999..... | 382,688 |
| 2000..... | 306,966 |
| 2001..... | 165,968 |
| 2002..... | 165,968 |
| Later years..... | 331,968 |
| | ----- |
| | \$1,741,793 |
| | ===== |

</TABLE>

The Company has sublet office space representing \$85,968, \$77,000 and \$59,083 of the future minimum rental payments in 1998, 1999 and 2000, respectively, and expects that it will attempt to sublease a substantial additional amount of its leased office space.

10. CONCENTRATIONS OF CREDIT RISK

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and advances to oil and gas ventures. See Note 6, Oil and Gas Properties and Investments, of Notes to Consolidated Financial Statements. The Company has temporary cash on deposit at major financial institutions, some of which are in excess of government insured limits. At December 31, 1997, December 31, 1996, and August 31, 1996, the Company had approximately \$19,000,000, \$27,000,000, and \$14,000,000 on deposit in four, four and two such institutions, respectively.

11. STOCKHOLDERS' EQUITY

On February 12, 1996, at an Annual Meeting of Stockholders, the stockholders of the Company approved an increase in the number of authorized shares of Common Stock from 25,000,000 to 50,000,000 having \$0.10 par value per share. The number of authorized shares of preferred stock of 5,000,000, also having a par value of \$0.10 per share, remained unchanged. As of December 31, 1997, 11,223,744 shares of Common Stock were issued and outstanding. No shares of preferred stock have been issued.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

11. STOCKHOLDERS' EQUITY -- (CONTINUED)

During the years ended August 31, 1995 and 1996, the four-month period ended December 31, 1996, and the year ended December 31, 1997, the following transactions regarding the Company's Common Stock and warrants and options to purchase the Company's Common Stock were consummated pursuant to authorization by the Company's Board of Directors or duly constituted committees thereof.

FISCAL YEAR ENDED AUGUST 31, 1995

- The following are included in the sales or retirement of Common Stock:
 - The issuance of 10,000 shares at a price of \$0.50 per share in a warrant exercise.
 - The issuance to investors of 1,622,000 shares and warrants exercisable at \$12.00 per share to purchase 1,622,000 shares, for aggregate proceeds of \$10,320,882 net of \$1,033,118 of related offering costs.
 - The issuance of 240,390 shares at a price of \$3.00 per share, 100,000 shares at a price of \$2.25 per share and 7,143 shares at a price of \$3.50 per share in a series of warrant exercises.
 - The retirement of 34 shares recorded at an aggregate of \$223.14 to reflect the payment of cash for fractional shares in connection with the December 1994 reverse stock split.
- The following are included in the issuance of Common Stock as employee compensation:
 - The adjustment to capital in excess of par in the amount of \$4,275 related to shares received by three employees for stock issued at below par.
 - The issuance of 11,740 shares at a price of \$6.18 per share, 2,000 shares at a price of \$8.76 per share, and 5,000 shares at a price of \$11.54 per share to employees resulting in aggregate compensation of \$147,763.
 - The issuance of 395,000 restricted shares at a value of \$3.28 per share for financial consulting services to be performed over two years amounting to \$1,296,000, of which \$1,134,875 was expensed in 1995 and the balance of

\$161,125 was expensed during fiscal 1996.

- The issuance of 2,353 shares at a price of \$8.50 per share for legal services in the amount of \$20,000.
- The issuance of 14,285 shares and warrants exercisable at \$3.50 per share to purchase 14,286 shares upon conversion of notes payable in an aggregate principal amount of \$50,000.
- The issuance of warrants exercisable at \$10.20 per share to purchase 569,900 shares to firms that participated in the distribution of the Company's securities.
- The issuance of 15,000 shares at a price of \$11.76 per share for consulting services in the amount of \$176,250.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

11. STOCKHOLDERS' EQUITY -- (CONTINUED)

- The issuance of 5,000 restricted shares at a price of \$7.12 per share along with a cash payment of \$60,000 for a paid-up license.

No options were exercised during the fiscal year ended August 31, 1995.

FISCAL YEAR ENDED AUGUST 31, 1996

- The issuance to investors of 2,500,000 shares for aggregate proceeds of \$20,960,354 net of \$1,539,646 of related offering costs.
- The following are included in the issuance of Common Stock for purchase of interests in oil and gas ventures:
 - The issuance of 75,000 shares at a price of \$9.125 per share, along with other consideration, in exchange for 10% of the equity of UK-RAN Oil Corporation and 33% of the equity of UK-RAN Energy Corporation.
 - The issuance of 150,000 shares at a price of \$11.125 per share in exchange for 6% of the equity of Intergas JSC, a joint stock company incorporated in the Russian Federation.
- The following are included in the issuance of Common Stock upon conversion of debentures:
 - The issuance of 498,662 shares in a series of conversions of an aggregate of \$3,450,000 principal amount of debentures convertible at various prices based on 82 1/2% of market price at the time of conversion.
 - The adjustment to capital in excess of par in the amount of \$311,088 related to deferred costs incurred in the issuance of debentures and \$795,500 related to the discount feature of the debentures.
- The following are included in the issuance of Common Stock upon warrant and option exercises:
 - The issuance of 26,000 shares at a price of \$3.00 per share in a series of option exercises.
 - The issuance of 21,611 shares at a price of \$3.00 per share in a series of warrant exercises.
- The issuance of options exercisable at \$7.6875 per share to purchase

15,000 shares granted to non-employee directors at February 12, 1996 pursuant to the Company's 1995 Long-Term Incentive Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

11. STOCKHOLDERS' EQUITY -- (CONTINUED)
FOUR MONTH PERIOD ENDED DECEMBER 31, 1996

- The following are included in the issuance of Common Stock upon conversion of debentures:
 - The issuance of 29,653 shares upon conversion of \$300,000 principal amount of debentures convertible at 82 1/2% of market price at the time of conversion.
 - The adjustment to capital in excess of par in the amount of \$19,599 related to deferred costs incurred in the issuance of debentures.
- The following are included in the issuance of Common Stock upon warrant and option exercises:
 - The issuance of 6,000 shares at a price of \$3.00 per share in a series of option exercises.
 - The issuance of 243,334 shares at a price of \$3.00 per share in a series of warrant exercises.
 - The issuance of 7,143 shares at a price of \$3.50 per share in a warrant exercise.
 - The issuance of 569,900 shares at a price of \$10.20 per share in a series of warrant exercises.
 - The issuance of 1,540,000 shares at a price of \$12.00 per share in a series of warrant exercises.
- The issuance of options exercisable at \$14.50 per share to purchase 190,750 shares granted to employees at December 31, 1996 pursuant to the Company's 1995 Long-Term Incentive Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.
- The issuance of options exercisable at \$17.98 per share to purchase 222,500 shares granted to employees at December 31, 1996 pursuant to the Company's 1995 Long-Term Incentive Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.

YEAR ENDED DECEMBER 31, 1997

- The issuance of 87,500 shares at a price of \$12.125 per share in connection with the acquisition of an interest in the Stynawske Field, Ukraine.
- The issuance of 52,000 shares at a price of \$3.00 per share in a series of option exercises.
- The issuance of options exercisable at \$9.00 per share to purchase 15,000 shares granted to non-employee directors at June 3, 1997 pursuant to the Company's 1995 Long-Term Incentive Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.

- The issuance of options exercisable at \$8.50 per share to purchase 3,500 shares granted to employees at June 30, 1997 pursuant to the Company's 1995 Long-Term Incentive

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

11. STOCKHOLDERS' EQUITY -- (CONTINUED)

Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.

- The issuance of options exercisable at \$10.54 per share to purchase 77,500 shares granted to employees at June 30, 1997 pursuant to the Company's 1995 Long-Term Incentive Plan. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.
- The cancellation of options to purchase an aggregate 63,084 shares which had been granted to employees pursuant to the Company's 1995 Long-Term Incentive Plan. Of the options cancelled, 59,584 were exercisable at \$14.50, 2,500 were exercisable at \$17.98, and 1,000 were exercisable at \$8.50. See Note 16, Stock-Based Compensation Plans, of Notes to Consolidated Financial Statements.

The following table summarizes warrants to purchase the Company's Common Stock, which were outstanding:

<TABLE>

<CAPTION>

| OUTSTANDING AT: | NUMBER OF WARRANTS | EXERCISE PRICE | EXPIRATION DATE |
|-----------------------|-----------------------|-------------------|---------------------------------------|
| - - - - - | - - - - - | - - - - - | - - - - - |
| <S> | <C> | <C> | <C> |
| August 31, 1994..... | 629,621 | \$.50 - \$ 3.50 | August 1, 1995 to November 3, 1997 |
| Issued..... | 2,191,900 | \$10.20 - \$12.00 | February 28, 1997 |
| Exercised..... | (357,533) | \$.50 - \$ 3.50 | August 1, 1995 to November 3, 1997 |
| August 31, 1995..... | 2,463,988 | \$ 3.00 - \$12.00 | February 28, 1997 to November 3, 1997 |
| Exercised..... | (21,611) | \$ 3.00 | November 3, 1997 |
| August 31, 1996..... | 2,442,377 | \$ 3.00 - \$12.00 | February 28, 1997 to November 3, 1997 |
| Exercised..... | (2,360,377) | \$ 3.00 - \$12.00 | February 28, 1997 to November 3, 1997 |
| Redeemed..... | (82,000) | \$12.00 | February 28, 1997 to November 3, 1997 |
| December 31, 1996.... | 0 | | |

</TABLE>

During the four month period ended December 31, 1996, an aggregate of 2,191,900 warrants were called for redemption by the Company. If the average closing price of the Company's Common Stock exceeded \$12.20 and \$14.00 per share for 10 consecutive trading days, upon election of the Company and notice to the warrant holders, the holders of 569,900 warrants and 1,622,000 warrants, respectively, were required either to exercise their warrants within a specified period or to have the warrants redeemed by the Company for a nominal redemption price. All but 82,000 of the 2,191,900 warrants called for redemption were exercised during the four month period ended December 31, 1996; the 82,000 warrants were redeemed. During the same period, an additional 250,477 warrants were also exercised by their holders. There were no outstanding warrants at December 31, 1996 and 1997.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

12. NET LOSS PER COMMON SHARE

Effective December 31, 1997 the Company adopted SFAS No. 128 Earnings Per Share, for all periods presented. Basic and diluted net loss per common share for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four month periods ended December 31, 1996 and 1995 were based on the weighted average number of common shares outstanding during those periods. The weighted average number of shares used was 11,206,506, 6,247,568, 4,170,891, 9,348,106 and 5,417,031, respectively. The Debentures, which were convertible into a maximum of 154,750 shares of the Company's Common Stock per \$1,000,000 principal amount of the Debentures, were not included in the computation of diluted net loss per common share for the four month period ended December 31, 1996 and the fiscal year ended August 31, 1996 because the effect of such inclusion would have been antidilutive. Additionally, options to purchase the Company's Common Stock were outstanding during the year ended December 31, 1997, the four month period ended December 31, 1996 and the fiscal years ended August 31, 1996 and 1995 and warrants to purchase the Company's Common Stock were outstanding during the four month period ended December 31, 1996, and the fiscal years ended August 31, 1996 and 1995 but were not included in the computation of diluted net loss per common share because the effect of such inclusion would have been antidilutive.

13. INCOME TAXES

The Company and its domestic subsidiaries file U.S. consolidated income tax returns. No benefit for U.S. income taxes has been recorded in these consolidated financial statements because of the Company's inability to recognize deferred tax assets under provisions of SFAS 109. Due to the implementation of the quasi-reorganization as of October 31, 1988, future reductions of the valuation allowance relating to those deferred tax assets existing at the date of the quasi-reorganization, if any, will be allocated to capital in excess of par value. The provision for income taxes for the year ended August 31, 1995 consisted of taxes applicable to foreign operations.

A reconciliation of the differences between income taxes computed at the U.S. federal statutory rate (34%) and the Company's reported provision for income taxes is as follows:

<TABLE>
<CAPTION>

| | YEAR ENDED DECEMBER 31, 1997 | FOUR MONTH PERIOD ENDED DECEMBER 31, 1996 | FOUR MONTH PERIOD ENDED DECEMBER 31, 1995 | YEAR ENDED AUGUST 31, 1996 | YEAR ENDED AUGUST 31, 1995 |
|--|------------------------------------|--|--|----------------------------------|----------------------------------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Income tax benefit at statutory rate..... | \$(9,412,203) | \$(885,515) | \$(490,342) | \$(2,207,808) | |
| Benefit of losses not recognized..... | 9,412,203 | 876,629 | 490,342 | 2,197,879 | 2,566,836 |
| Foreign tax provision..... | -- | -- | -- | -- | 28,600 |
| Other, net..... | -- | 8,886 | -- | 9,929 | 7,308 |
| Provision for income taxes..... | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 28,600 |
| Effective tax rate... | 0% | 0% | 0% | 0% | |

0.4%
</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

13. INCOME TAXES -- (CONTINUED)

The components of the deferred tax assets as of December 31, 1997, December 31, 1996 and August 31, 1996 were as follows:

<TABLE>
<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|--|----------------------------|----------------------------|----------------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Net operating loss carryforwards..... | \$ 13,372,000 | \$ 9,520,000 | \$ 8,906,000 |
| Foreign net operating loss carryforwards..... | 4,972,000 | 1,300,000 | 1,300,000 |
| Impairments..... | 6,817,000 | -- | -- |
| Patent rights and related equipment..... | 225,473 | 975,803 | 1,282,072 |
| Bad debt allowance..... | -- | 35,776 | 35,776 |
| Foreign tax credits..... | -- | 28,600 | 28,600 |
| | ----- | ----- | ----- |
| Valuation allowance..... | 25,386,473 (25,386,473) | 11,860,179 (11,860,179) | 11,552,448 (11,552,448) |
| | ----- | ----- | ----- |
| Net deferred tax asset recognized in balance sheet..... | \$ -- | \$ -- | \$ -- |
| | ===== | ===== | ===== |

</TABLE>

On August 1, 1991, and subsequently on August 17, 1994, the Company experienced changes in the Company's ownership as defined in Section 382 of the Internal Revenue Code ("IRC"). The effect of these changes in ownership is to limit the utilization of certain existing net operating loss carryforwards for income tax purposes to approximately \$1,375,000 per year on a cumulative basis. As of December 31, 1997, total U.S. net operating loss carryforwards were approximately \$39,331,000. Of that amount, approximately \$15,100,000 was incurred subsequent to the ownership change in 1994, \$19,531,000 was incurred prior to 1994 and therefore is subject to the IRC Section 382 limitation and \$4,700,000 is subject to the separate return limitation rules. See Note 1 of Notes to Consolidated Financial Statements. The net operating loss carryforwards expire from 1998 to 2012. The net operating loss carryforwards limited under the separate return limitation rules may only be offset against the separate income of the respective subsidiaries. The Company has also generated approximately \$14,161,000 of foreign net operating loss carryforwards. A significant portion of the foreign net operating loss carryforwards are subject to limitations similar to IRC Section 382.

The Company's available net operating loss carryforwards may be used to offset future taxable income, if any, prior to their expiration. The Company may experience further limitations on the utilization of net operating loss carryforwards and other tax benefits as a result of additional changes in ownership.

The Company also has investment tax credit carryovers of \$46,546, which begin to expire in 1998.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. SEGMENTS

During the year ended December 31, 1997 and the four months ended December 31, 1996, the Company operated through one business segment, oil and gas exploration and production, reflecting its decision to use its electrically enhanced oil recovery ("EEOR") technology primarily internally as a competitive advantage to obtain and exploit interests in heavy oil fields and not to pursue external sales of goods and services related to the EEOR technology. Since oil and gas exploration and production activities were at a preliminary stage, revenues for the periods ended December 31, 1997 and 1996 were minimal. For the fiscal years ended August 31, 1996 and 1995, EEOR activities were reported as a separate business segment. For the fiscal year ended August 31, 1995 EEOR revenues related to contracts with one customer in each of Canada and China, and for the fiscal year ended August 31, 1996, EEOR revenues related to a contract with one customer in Canada.

Operating revenues for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four months ended December 31, 1996 by business segment and geographical area were as follows:

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | AUGUST 31, 1996 | AUGUST 31, 1995 | DECEMBER 31, 1996 |
|--|----------------------|--------------------|--------------------|----------------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| Oil and Gas Acquisition and Development | | | | |
| United States..... | \$ -- | \$ 2,624 | \$ -- | \$ -- |
| Canada..... | 313,301 | 23,938 | -- | 16,980 |
| | ----- | ----- | ----- | ----- |
| Total..... | \$ 313,301 | \$ 26,562 | \$ 0 | \$ 16,980 |
| | ===== | ===== | ===== | ===== |
| EEOR Process Sales and Service | | | | |
| United States..... | \$ -- | \$ -- | \$ -- | \$ -- |
| Canada..... | -- | 8,615 | 255,457 | -- |
| China..... | -- | -- | 370,000 | -- |
| Other..... | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- |
| Total..... | \$ 0 | \$ 8,615 | \$ 625,457 | \$ 0 |
| | ===== | ===== | ===== | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. SEGMENTS -- (CONTINUED)

Operating profit (loss) for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four months ended December 31, 1996 by business segment and geographical area were as follows:

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | AUGUST 31, 1996 | AUGUST 31, 1995 | DECEMBER 31, 1996 |
|-----|----------------------|--------------------|--------------------|----------------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |

Oil and Gas Acquisition
and Development

| | | | | |
|--------------------------------|----------------|---------------|---------------|---------------|
| United States..... | \$ (257,407) | \$ (3,262) | \$ (608,822) | \$ -- |
| Canada..... | (97,541) | 18,836 | -- | 11,378 |
| Eastern Europe..... | (24,831,798) | (1,770,434) | -- | (1,712,924) |
| | ----- | ----- | ----- | ----- |
| Total..... | \$(25,186,746) | \$(1,754,860) | \$ (608,822) | \$(1,701,546) |
| | ===== | ===== | ===== | ===== |
| EEOR Process Sales and Service | | | | |
| United States..... | \$ -- | \$ -- | \$ (25) | \$ -- |
| Canada..... | -- | (30,857) | (3,208,144) | -- |
| China..... | -- | -- | 116,915 | -- |
| Other..... | -- | -- | (18,296) | -- |
| | ----- | ----- | ----- | ----- |
| | \$ -- | \$ (30,857) | \$(3,109,550) | \$ -- |
| | ===== | ===== | ===== | ===== |
| Corporate expenses..... | \$ (3,903,446) | \$(3,853,972) | \$(4,164,548) | \$(1,281,821) |
| | ===== | ===== | ===== | ===== |
| Total..... | \$(29,090,192) | \$(5,639,689) | \$(7,882,920) | \$(2,983,367) |
| | ===== | ===== | ===== | ===== |

</TABLE>

The Company's loss from investments in unconsolidated subsidiaries pertains primarily to operations in Eastern Europe.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. SEGMENTS -- (CONTINUED)

Identifiable Assets as of December 31, 1997 and 1996 and August 31, 1996 by business segment and geographical area were as follows:

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 | AUGUST 31, 1996 |
|---|----------------------|----------------------|--------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Corporate(1) | | | |
| United States..... | \$ 212,536 | \$ 7,580,219 | \$10,239,148 |
| Canada..... | -- | -- | -- |
| Western Europe..... | 24,263,223 | 29,049,022 | 7,517,066 |
| | ----- | ----- | ----- |
| Total..... | \$24,475,759 | \$36,629,241 | \$17,756,214 |
| | ===== | ===== | ===== |
| Oil and Gas Acquisition and Development | | | |
| United States..... | \$ -- | \$ 6,786,714 | \$ 5,705,663 |
| Canada..... | 2,067,257 | 831,930 | 642,451 |
| Eastern Europe..... | 5,386,707 | 11,127,176 | 7,984,213 |
| Western Europe..... | 5,504,312 | -- | -- |
| | ----- | ----- | ----- |
| Total..... | \$12,958,276 | \$18,745,820 | \$14,332,327 |
| | ----- | ----- | ----- |
| Identifiable Assets -- Total..... | \$37,434,035 | \$55,375,061 | \$32,088,541 |
| | ===== | ===== | ===== |

</TABLE>

(1) Principally cash and cash equivalents.

The percentage of operating revenues for the years ended December 31, 1997 and August 31, 1996 and 1995 and the four months ended December 31, 1996 by business segment and geographical area are as follows:

<TABLE>

<CAPTION>

| | DECEMBER 31, 1997 | AUGUST 31, 1996 | AUGUST 31, 1995 | DECEMBER 31, 1996 |
|---|----------------------|--------------------|--------------------|----------------------|
| | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| Oil and Gas Acquisition and Development | | | | |
| United States..... | -- | 10% | -- | -- |
| Canada..... | 100% | 90% | -- | 100% |
| EEOR Process Sales and Service | | | | |
| Canada..... | -- | 100% | 41% | -- |
| China..... | -- | -- | 59% | -- |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

15. SUPPLEMENTAL CASH FLOW INFORMATION AND NONMONETARY TRANSACTIONS

The following represents supplemental cash flow information for the years ended December 31, 1997, and August 31, 1996 and 1995 and for the four-month periods ended December 31, 1996 and 1995:

<TABLE>

<CAPTION>

| | YEARS ENDED | | | 4 MONTHS ENDED | |
|--|--------------|------------|------------|----------------|----------|
| | DECEMBER 31, | AUGUST 31, | AUGUST 31, | DECEMBER 31, | DECEMBER |
| | 1997 | 1996 | 1995 | 1996 | 1995 |
| | ----- | ----- | ----- | ----- | ----- |
| --- | | | | | |
| 31, | | | | | |
| --- | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Supplemental disclosures of cash flow information: | | | | | |
| Interest paid during the year..... | \$ -- | \$ 146 | \$ 28 | \$ 17 | \$ 3 |
| | ----- | ----- | ----- | ----- | ----- |
| Supplemental schedule of non-cash activities: | | | | | |
| Acquisition of common stock of subsidiaries resulting in elimination upon consolidation and cancellation of notes receivable of \$2,450,000 and \$530,000, respectively..... | -- | 2,980 | -- | -- | 2,450 |
| | ----- | ----- | ----- | ----- | ----- |
| Issuance of Common Stock | | | | | |

| | | | | | |
|--|-------|-------|-------|------|-------|
| upon conversion of convertible debentures and notes..... | -- | 3,934 | 50 | 280 | -- |
| | ----- | ----- | ----- | ---- | ----- |
| Issuance of Common Stock in connection with investments in oil and gas ventures..... | 1,060 | 2,353 | -- | -- | -- |
| | ----- | ----- | ----- | ---- | ----- |
| Issuance of Common Stock in connection with compensation earned and third party services provided..... | -- | -- | 1,730 | -- | -- |
| | ----- | ----- | ----- | ---- | ----- |
| Accruals recorded applicable to effective guaranty of Kashtan obligation and Lelyaki Field close-down costs..... | 8,971 | -- | 59 | 678 | -- |
| | ----- | ----- | ----- | ---- | ----- |

</TABLE>

16. STOCK-BASED COMPENSATION PLANS

On August 17, 1994, options to purchase 200,000 shares of the Company's Common Stock were issued to various individuals who were serving or were expected in the future to serve the Company as officers, directors, employees, consultants and advisors (the "1994 Plan"). The options are exercisable at an exercise price of \$3.00 and are only exercisable at the time or within six months after services are rendered by such individuals. All of these options expire August 16, 1999.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. STOCK-BASED COMPENSATION PLANS -- (CONTINUED)

Pursuant to the 1995 Long-Term Incentive Plan (the "1995 Plan") adopted by the Company in February 1996, 750,000 shares of the Company's Common Stock have been authorized for possible issuance under the 1995 Plan. The purpose of the 1995 Plan is to further the interest of the Company by enabling employees, directors, consultants and advisors of the Company to acquire an interest in the Company by ownership of its stock through the exercise of stock options and stock appreciation rights granted under the 1995 Plan. Stock options granted under the 1995 Plan may be either incentive stock options or non-qualified stock options. Options expire on such date as is determined by the committee administering the 1995 Plan, except that incentive stock options may expire no later than 10 years from the date of grant. Pursuant to the 1995 Plan, a specified number of stock options exercisable at the then market price are granted annually to non-employee directors of the Company, which become 100% vested six months from the date of grant. Stock appreciation rights entitle the holder to receive payment in cash or Common Stock equal in value to the excess of the fair market value of a specified number of shares of Common Stock on the date of exercise over the exercise price of the stock appreciation right. No stock appreciation rights have been granted through December 31, 1997. The exercise price and vesting schedule of stock appreciation rights are determined at the date of grant.

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. STOCK-BASED COMPENSATION PLANS -- (CONTINUED)

A summary of the status of stock options granted under the 1994 and 1995 Plans is as follows:

<TABLE>

<CAPTION>

| | SHARES AVAILABLE FOR ISSUE | SHARES ISSUABLE UNDER OUTSTANDING OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE |
|-----------------------------------|----------------------------------|---|---------------------------------------|
| | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> |
| Balance at August 31, 1995..... | 0 | 200,000 | |
| 1995 Plan Authorization..... | 750,000 | | |
| Options: | | | |
| Granted at market..... | (15,000) | 15,000 | \$ 7.68 |
| Exercised..... | -- | (26,000) | \$ 3.00 |
| | ----- | ----- | |
| Balance at August 31, 1996..... | 735,000 | 189,000 | \$ 3.37 |
| Options: | | | |
| Granted at market..... | (190,750) | 190,750 | \$14.50 |
| Granted at a premium..... | (222,500) | 222,500 | \$17.98 |
| Exercised..... | -- | (6,000) | \$ 3.00 |
| | ----- | ----- | |
| Balance at December 31, 1996..... | 321,750 | 596,250 | \$12.39 |
| Options: | | | |
| Granted at market..... | (18,500) | 18,500 | \$ 8.90 |
| Granted at a premium..... | (77,500) | 77,500 | \$10.54 |
| Exercised..... | -- | (52,000) | \$ 3.00 |
| Cancelled..... | 63,084 | (63,084) | \$14.54 |
| | ----- | ----- | |
| Balance at December 31, 1997..... | 288,834 | 577,166 | \$12.64 |
| | ----- | ----- | |

</TABLE>

The shares issuable upon exercise of vested options and the corresponding weighted average exercise price are as follows:

<TABLE>

<CAPTION>

| | SHARES ISSUABLE UNDER EXERCISABLE OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE |
|------------------------|---|---------------------------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| August 31, 1995..... | 172,000 | \$3.00 |
| August 31, 1996..... | 171,000 | \$3.42 |
| December 31, 1996..... | 165,000 | \$3.42 |
| December 31, 1997..... | 177,832 | \$7.12 |

</TABLE>

The weighted average fair value of options granted at market was \$2.92, \$7.30 and \$2.02 for the year ended December 31, 1997, the four month period ended December 31, 1996 and the fiscal year ended August 31, 1996, respectively. The weighted average fair value of options granted at a premium was \$1.84 and \$3.46 for the year ended December 31, 1997

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CANARGO ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. STOCK-BASED COMPENSATION PLANS -- (CONTINUED)

and the four month period ended December 31, 1996, respectively; no options were granted at a premium for the fiscal year ended August 31, 1996. The weighted average fair value of all options granted during the year ended December 31, 1997, the four month period ended December 31, 1996 and the fiscal year ended August 31, 1996 was \$2.06, \$5.04 and \$2.02, respectively.

The following table summarizes information about stock options outstanding at December 31, 1997:

<TABLE>

<CAPTION>

| OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | | |
|---|--|------------------------------------|------------------------------------|--|-----|
| RANGE OF WEIGHTED AVERAGE EXERCISE PRICES EXERCISE PRICE | NUMBER OF SHARES OUTSTANDING AT DECEMBER 31, 1997 | WEIGHTED AVERAGE REMAINING TERM | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER OF SHARES EXERCISABLE AT DECEMBER 31, 1997 | |
| | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| \$ 3.00 to \$ 7.68 | 131,000 | 1.57 | \$ 3.54 | 131,000 | |
| \$ 3.62 | | | | | |
| \$ 7.70 to \$10.60 | 95,000 | 1.92 | \$10.24 | 15,000 | |
| \$ 9.00 | | | | | |
| \$10.62 to \$17.98 | 351,166 | 2.95 | \$16.68 | 49,832 | |
| \$14.50 | | | | | |
| \$ 3.00 to \$17.98 | 577,166 | | | 177,832 | |
| ===== | ===== | | | ===== | |

</TABLE>

As discussed in Note 2, Summary of Significant Accounting Policies, under "Stock-Based Compensation Plans," of Notes to Consolidated Financial Statements, the Company accounts for its stock-based compensation plans under APB Opinion 25. Accordingly, no compensation cost has been recognized for those stock options with exercise prices equal to or greater than the market price of the stock on the date of grant. Under SFAS No. 123, compensation cost is measured at the grant date based on the fair value of the awards and is recognized over the service period, which is usually the vesting period. Had compensation cost for those stock options been determined consistent with SFAS No. 123, the Company's net loss and net loss per common share would have been approximately \$28,600,000 and \$2.56, respectively, for the fiscal year ended December 31, 1997 and approximately \$6,500,000 and \$1.04, respectively, for the year ended August 31, 1996. Stock options had no effect on net loss for the four months ended December 31, 1996. This effect is not likely to be representative of future pro forma amounts because of the exclusion of costs of grants before 1995 and the addition of awards to be granted in future years. The fair value of each stock option granted by the Company was calculated using the Black-Scholes option-pricing model applying the following weighted-average assumptions for the year ended December 31, 1997, the four month period ended December 31, 1996, and the fiscal year ended August 31, 1996: dividend yield of 0.00%; risk-free interest rates are different for each grant and range from 6.08% to 6.36% for the year ended December 31, 1997, 5.79% to 6.16% for the four month period ended December 31, 1996, and during the fiscal year ended August 31, 1996, only one grant was made with a risk-free interest rate of 4.79%; the average expected lives of options of 2.1 years, 3.1 years and 1.5 years, respectively; and volatility of 44.7% for the year ended December 31, 1997 and 49% for the four month period ended December 31, 1996 and the fiscal year ended August 31, 1996.

CANARGO ENERGY CORPORATION

SUPPLEMENTAL FINANCIAL INFORMATION

SUPPLEMENTAL OIL AND GAS DISCLOSURES -- UNAUDITED

ESTIMATED NET QUANTITIES OF OIL AND GAS RESERVES

Users of this information should be aware that the process of estimating quantities of "proved" and "proved developed" natural gas and crude oil reserves is very complex, requiring significant subjective decisions in the evaluation of all available geological, engineering and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving production history and continual reassessment of the viability of production under varying economic conditions. Consequently, material revisions to existing reserve estimates occur from time to time. Although every reasonable effort is made to ensure that reserve estimates reported represent the most accurate assessments possible, the significance of the subjective decisions required and variances in available data for various reservoirs make these estimates generally less precise than other estimates presented in connection with financial statement disclosures.

Proved reserves are estimated quantities of natural gas, crude oil and condensate that geological and engineering data demonstrate, with reasonable certainty, to be recoverable in future years from known reservoirs with existing equipment under existing economic and operating conditions.

Proved developed reserves are proved reserves that can be expected to be recovered through existing wells with existing equipment and under existing economic and operating conditions.

No major discovery or other favorable or adverse event subsequent to December 31, 1997 is believed to have caused a material change in the estimates of proved or proved developed reserves as of that date.

The following table sets forth the Company's net proved reserves, including the changes therein, and proved developed reserves (all within Canada) at December 31, 1997, as estimated by the Company's petroleum engineering staff:

<TABLE>
<CAPTION>

| | OIL (BBLS) |
|--|------------|
| | ----- |
| <S> | <C> |
| December 31, 1996 | |
| Purchase of properties..... | 115,500 |
| Revisions of previous estimates..... | (33,000) |
| Extensions, discoveries and other additions..... | 267,300 |
| Production..... | (16,000) |
| | ----- |
| December 31, 1997..... | 333,800 |
| | ----- |
| Proved developed | |
| December 31, 1997..... | 155,000 |
| | ----- |

</TABLE>

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CANARGO ENERGY CORPORATION

SUPPLEMENTAL FINANCIAL INFORMATION -- CONTINUED

SUPPLEMENTAL OIL AND GAS DISCLOSURES -- UNAUDITED

Costs incurred for oil and gas property acquisition, exploration and development activities for the year ended December 31, 1997, the four months ended December 31, 1996 and the years ended August 31, 1996 and 1995 are as follows:

<TABLE>

<CAPTION>

DECEMBER 31, 1997

CANADA

| ----- | |
|---------------------------|-------------|
| <S> | |
| <C> | |
| Property Acquisition | |
| Unproved*..... | \$ 324,500 |
| Proved..... | 684,500 |
| Exploration..... | -- |
| Development..... | 680,974 |
| | ----- |
| Total costs incurred..... | \$1,689,974 |
| | ===== |

<CAPTION>

DECEMBER 31, 1996

UNITED STATES

| ----- | |
|---------------------------|------------|
| Property acquisition: | |
| Unproved*..... | \$ 259,338 |
| Proved..... | 0 |
| Exploration..... | -- |
| Development..... | -- |
| | ----- |
| Total costs incurred..... | \$ 259,338 |
| | ===== |

<CAPTION>

AUGUST 31, 1996

UNITED STATES

| ----- | |
|---------------------------|------------|
| Property acquisition: | |
| Unproved*..... | \$ 287,788 |
| Proved..... | 0 |
| Exploration..... | -- |
| Development..... | -- |
| | ----- |
| Total costs incurred..... | \$ 287,788 |
| | ===== |

<CAPTION>

AUGUST 31, 1995

UNITED STATES

| ----- | |
|---------------------------|------------|
| Property acquisition: | |
| Unproved*..... | \$ 519,304 |
| Proved..... | 32,381 |
| Exploration..... | -- |
| Development..... | -- |
| | ----- |
| Total costs incurred..... | \$ 551,685 |
| | ===== |

</TABLE>

* These amounts represent costs incurred by the Company and excluded from the amortization base until proved reserves are established or impairment is determined.

CANARGO ENERGY CORPORATION

SUPPLEMENTAL FINANCIAL INFORMATION -- CONTINUED

SUPPLEMENTAL OIL AND GAS DISCLOSURES -- UNAUDITED

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS RELATING TO PROVED OIL AND GAS RESERVES

The following information has been developed utilizing procedures prescribed by SFAS No. 69 Disclosure about Oil and Gas Producing Activities ("SFAS 69") and based on crude oil reserve and production volumes estimated by the Company's engineering staff. It may be useful for certain comparative purposes, but should not be solely relied upon in evaluating the Company or its performance. Further, information contained in the following table should not be considered as representative of realistic assessments of future cash flows, nor should the Standardized Measure of Discounted Future Net Cash Flows be viewed as representative of the current value of the Company.

The Company believes that the following factors should be taken into account in reviewing the following information: (1) future costs and selling prices will probably differ from those required to be used in these calculations; (2) actual rates of production achieved in future years may vary significantly from the rate of production assumed in the calculations; (3) selection of a 10% discount rate is arbitrary and may not be reasonable as a measure of the relative risk inherent in realizing future net oil and gas revenues; and (4) future net revenues may be subject to different rates of income taxation.

Under the Standardized Measure, future cash inflows were estimated by applying period-end oil prices adjusted for fixed and determinable escalations to the estimated future production of period-end proven reserves. Future cash inflows were reduced by estimated future development, abandonment and production costs based on period-end costs in order to arrive at net cash flow before tax. Future income tax expenses has been computed by applying period-end statutory tax rates to aggregate future pre-tax net cash flows, reduced by the tax basis of the properties involved and tax carryforwards. Use of a 10% discount rate is required by SFAS No. 69.

Management does not rely solely upon the following information in making investment and operating decisions. Such decisions are based upon a wide range of factors, including estimates of probable as well as proven reserves and varying price and cost assumptions considered more representative of a range of possible economic conditions that may be anticipated.

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CANARGO ENERGY CORPORATION

SUPPLEMENTAL FINANCIAL INFORMATION -- CONTINUED

SUPPLEMENTAL OIL AND GAS DISCLOSURES -- UNAUDITED

The standardized measure of discounted future net cash flows relating to proved oil and gas reserves (all within Canada) is as follows:

<TABLE>
<CAPTION>

| | AS OF DECEMBER 31, 1997 ----- |
|--------------------------|--|
| <S> | <C> |
| Future cash inflows..... | \$5,469,000 |
| Less related future: | |
| Production costs..... | 2,090,000 |

| | |
|--|-------------|
| Development and abandonment costs..... | 840,000 |
| Income taxes..... | -- |
| | ----- |
| Future net cash flows..... | 2,539,000 |
| 10% annual discount for estimating timing of cash flows..... | 1,296,000 |
| | ----- |
| Standardized measure of discounted future net cash flows before income taxes..... | \$1,243,000 |
| | ===== |

</TABLE>

A summary of the changes in the standardized measure of discounted future net cash flows applicable to proved oil and gas reserves (all within Canada) is as follows:

<TABLE>

<CAPTION>

| | YEAR ENDED DECEMBER 31, 1997 |
|---|------------------------------------|
| | ----- |
| <S> | <C> |
| Beginning of period..... | \$ -- |
| Purchase of reserves in place..... | 551,000 |
| Revisions of previous estimates: | |
| Changes in prices and costs..... | 67,000 |
| Changes in quantities..... | (208,000) |
| Changes in future development costs..... | -- |
| Development costs incurred during the period..... | -- |
| Additions to proved reserves resulting from extensions, discoveries and improved recovery, less related costs..... | 745,000 |
| Accretion of discount..... | 55,000 |
| Sales of oil and gas, net of production costs..... | (113,000) |
| Net change in income taxes..... | -- |
| Production timing and other..... | 146,000 |
| | ----- |
| Net increase..... | 1,243,000 |
| | ----- |
| End of the period..... | \$1,243,000 |
| | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEET

AS AT SEPTEMBER 30, 1998 AND DECEMBER 31, 1997

<TABLE>

<CAPTION>

| | SEPTEMBER 30, 1998 | DECEMBER 31, 1997 |
|--------------------------------|-----------------------|----------------------|
| | ----- | ----- |
| | (UNAUDITED) | |
| <S> | <C> | <C> |
| | | |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents..... | \$ 6,091,216 | \$ 14,164,177 |
| Restricted cash..... | -- | 9,700,000 |
| Accounts receivable..... | 454,422 | -- |
| Advances to operator..... | 1,764,305 | -- |
| Inventory..... | 170,405 | -- |

| | | |
|---|---------------|---------------|
| Other current assets..... | 344,534 | 761,904 |
| Total current assets..... | 8,824,882 | 24,626,081 |
| Property and equipment, net..... | 7,161,187 | 5,942,273 |
| Oil and gas properties, net, full cost method (including unevaluated amounts of \$11,451,363 and \$324,500, respectively)..... | 26,729,009 | 1,478,974 |
| Investment in and advances to oil and gas ventures, net..... | 5,361,531 | 5,386,707 |
| TOTAL ASSETS..... | \$ 48,076,609 | \$ 37,434,035 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable..... | \$ 460,916 | \$ 328,171 |
| Due to affiliated entity..... | 338,728 | -- |
| Accrued liabilities..... | 1,308,187 | 10,326,608 |
| Total current liabilities..... | 2,107,831 | 10,654,779 |
| Long-term debt..... | 895,500 | -- |
| Minority interest in subsidiaries..... | 3,384,503 | -- |
| Total liabilities..... | 6,387,834 | 10,654,779 |
| Stockholders' Equity: | | |
| Preferred stock..... | -- | -- |
| Common stock, 11,223,744 shares issued and outstanding; 9,970,900 additional shares issuable without receipt of further consideration..... | 2,119,464 | 1,122,374 |
| Capital in excess of par value..... | 101,865,441 | 83,162,531 |
| Accumulated deficit since October 31, 1988..... | (62,296,130) | (57,505,649) |
| Total stockholders' equity..... | 41,688,775 | 26,779,256 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY..... | \$ 48,076,609 | \$ 37,434,035 |
| | ===== | ===== |

</TABLE>

See accompanying notes to unaudited consolidated condensed financial statements.

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CANARGO ENERGY CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

<TABLE>

<CAPTION>

| | THREE MONTHS ENDED | | NINE MONTHS ENDED | |
|-----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | SEPTEMBER 30, 1998 | SEPTEMBER 30, 1997 | SEPTEMBER 30, 1998 | SEPTEMBER 30, 1997 |
| | (UNAUDITED) | | (UNAUDITED) | |
| <S> | <C> | <C> | <C> | <C> |
| Operating Revenues: | | | | |
| Oil and gas production..... | \$ 375,502 | \$ 63,158 | \$ 508,018 | \$ 172,818 |
| Other..... | (28) | -- | 11,972 | -- |
| | 375,474 | 63,158 | 519,990 | 172,818 |

| | | | | |
|--|------------|-------------|-------------|-------------|
| Operating Expenses: | | | | |
| Lease operating expense.... | 299,636 | 48,696 | 477,263 | 116,746 |
| Cost of sales..... | -- | -- | 10,891 | -- |
| Other direct project cost..... | 227,961 | 420,656 | 1,012,445 | 814,509 |
| General and administrative..... | 517,069 | 569,444 | 2,720,932 | 2,716,823 |
| Depreciation, depletion and amortization..... | 100,949 | 80,483 | 261,420 | 158,111 |
| Equity loss in unconsolidated subsidiaries..... | 16,848 | 1,646,587 | 152,225 | 3,011,369 |
| Writedown of oil and gas properties..... | -- | -- | 900,000 | -- |
| | 1,162,463 | 2,765,866 | 5,535,176 | 6,817,558 |
| OPERATING LOSS..... | 786,989 | 2,702,708 | 5,015,186 | 6,644,740 |
| Other Income (Expense): | | | | |
| Interest, net..... | (1,590) | 417,083 | 241,209 | 1,117,363 |
| Other income (expense).... | (46,232) | (27,153) | (42,232) | (68,460) |
| Loss on disposition of equipment..... | -- | (43,824) | (27,698) | (265,617) |
| TOTAL OTHER INCOME (EXPENSE)..... | (47,822) | 346,106 | 171,279 | 783,286 |
| Minority interest in loss of consolidated subsidiary.... | 53,426 | 106,946 | 53,426 | 186,390 |
| NET LOSS..... | \$ 781,385 | \$2,249,656 | \$4,790,481 | \$5,675,064 |
| | ===== | ===== | ===== | ===== |
| Weighted average number of common shares issued and issuable without receipt of additional consideration... | 19,677,333 | 11,223,744 | 14,072,572 | 11,200,757 |
| BASIC AND DILUTED NET LOSS PER COMMON SHARE..... | \$ (0.04) | \$ (0.20) | \$ (0.34) | \$ (0.51) |
| | ===== | ===== | ===== | ===== |

</TABLE>

See accompanying notes to unaudited consolidated condensed financial statements.

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CANARGO ENERGY CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

<TABLE>
<CAPTION>

| NINE MONTHS ENDED | |
|-----------------------|-----------------------|
| SEPTEMBER 30, 1998 | SEPTEMBER 30, 1997 |
| (UNAUDITED) | |
| <C> | <C> |

<S>
Operating activities:

| | | |
|--|----------------|----------------|
| Net loss..... | \$ (4,790,481) | \$ (5,675,064) |
| Loss on disposition of equipment..... | 27,698 | 265,617 |
| Equity loss in unconsolidated subsidiaries..... | 152,225 | 3,011,369 |
| Minority interest in loss of consolidated subsidiary..... | (53,426) | (186,390) |
| Depreciation, depletion and amortization..... | 261,420 | 158,111 |
| Writedown of oil and gas properties..... | 900,000 | -- |
| Changes in assets and liabilities: | | |
| Accounts receivable..... | 423,048 | (194,004) |
| Advances to operator..... | (523,610) | |
| Inventory..... | (150,000) | |
| Other current assets..... | 440,881 | (838,317) |
| Accounts payable..... | (1,915,108) | (288,117) |
| Accrued liabilities..... | (9,018,421) | (509,586) |
| | ----- | ----- |
| NET CASH USED IN OPERATING ACTIVITIES..... | (14,245,774) | (4,256,381) |
| | ----- | ----- |
| Investing activities: | | |
| Restricted cash..... | 9,700,000 | (4,300,000) |
| Acquisition costs..... | (1,214,948) | -- |
| Investments in oil and gas properties..... | (1,224,145) | (997,479) |
| Purchase of property and equipment..... | (1,896,493) | (907,275) |
| Proceeds from disposition of assets..... | -- | 232,638 |
| Investments in and advances to oil and gas ventures..... | (127,049) | (4,386,669) |
| | ----- | ----- |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES..... | 5,237,365 | (10,358,785) |
| | ----- | ----- |
| Financing activities: | | |
| Cash acquired..... | 935,448 | -- |
| Proceeds from exercise of options..... | -- | 156,000 |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES..... | 935,448 | 156,000 |
| | ----- | ----- |
| NET DECREASE IN CASH AND CASH EQUIVALENTS..... | (8,072,961) | (14,459,166) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD.... | 14,164,177 | 31,424,064 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, END OF PERIOD..... | \$ 6,091,216 | \$ 16,964,898 |
| | ===== | ===== |
| Non cash investing and financing activities: | | |
| Issuance of common stock in connection with investments in oil and gas ventures..... | \$ -- | \$ 1,060,937 |
| | ===== | ===== |
| Common stock issuable in connection with acquisition of subsidiary..... | \$ 19,700,000 | \$ -- |
| | ===== | ===== |

</TABLE>

See accompanying notes to unaudited consolidated condensed financial statements.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTSNINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

1. BASIS OF PRESENTATION

The interim consolidated condensed financial statements and notes thereto of

CanArgo Energy Corporation and its subsidiaries (collectively, the Company) have been prepared by management without audit. In the opinion of management, the consolidated condensed financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results for the interim period. The accompanying consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Report on Form 10-K/A for the year ended December 31, 1997 filed with the Securities and Exchange Commission.

On July 15, 1998 the Company filed with the Delaware Secretary of State amendments to its Certificate of Incorporation to effect a one-for-two reverse split of the shares of the Company's Common Stock (the "Reverse Split") and to change the Company's name from Fountain Oil Incorporated to CanArgo Energy Corporation. The reverse split has been reflected retroactively in the accompanying financial statements.

OIL AND GAS PROPERTIES

The Company and the unconsolidated entities for which it accounts using the equity method account for oil and gas properties and interests under the full cost method. Under this accounting method, costs, including a portion of internal costs associated with property acquisition and exploration for and development of oil and gas reserves, are capitalized within cost centers established on a country-by-country basis. Capitalized costs within a cost center, as well as the estimated future expenditures to develop proved reserves and estimated net costs of dismantlement and abandonment, are amortized using the unit-of-production method based on estimated proved oil and gas reserves. All costs relating to production activities are charged to expense as incurred.

Capitalized oil and gas property costs, less accumulated depreciation, depletion and amortization and related deferred income taxes, are limited to an amount (the ceiling limitation) equal to (a) the present value (discounted at 10%) of estimated future net revenues from the projected production of proved oil and gas reserves, calculated at prices in effect as of the balance sheet date (with consideration of price changes only to the extent provided by fixed and determinable contractual arrangements), plus (b) the lower of cost or estimated fair value of unproved and unevaluated properties, less (c) income tax effects related to differences in the book and tax basis of the oil and gas properties.

2. BUSINESS COMBINATION

On July 15, 1998, the Company completed the acquisition of all of the common stock of CanArgo Energy Inc. ("CEI") for Common Stock consideration valued at \$19,700,000. CEI is an oil and gas exploration, development and production company whose principal operations are located in the Republic of Georgia. On completion of the acquisition, CEI

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

2. BUSINESS COMBINATION -- (CONTINUED)

became a subsidiary of the Company, and each previously outstanding share of CEI Common Stock was converted into the right to receive 0.8 shares (1.6 shares pre-Reverse Split) of the Company's Common Stock, giving the former shareholders of CEI the right to receive approximately 47% of the Company's Common Stock. In addition, the former management of CEI now hold a majority of the Company's senior management positions.

Under purchase accounting, CEI's results have been included in the Company's consolidated financial statements since the date of acquisition. The following pro forma statements of operations give effect to the business combination as if such business combination had occurred on January 1, 1997; however, as CEI commenced operations in June of 1997, the pro forma financial statements of operations have been adjusted to reflect the results of operations of Ninotsminda Oil Company Limited ("NOC"), a 55.9% subsidiary of CEI and now the Company, from January 1, 1997 to June 30, 1997. The historical results of operations have been adjusted to reflect (i) revenues and expenses attributable to the Ninotsminda Field and (ii) the difference between the properties, historical depletion, depreciation and amortization and such expenses calculated based on the value allocated to the acquired assets. Management does not believe the pro forma amounts are indicative of the results of operations that would have been reported had the business combination occurred prior to January 1, 1997 or that may be reported in the future.

<TABLE>
<CAPTION>

| PRO FORMA | |
|---|---|
| NINE MONTHS ENDED SEPTEMBER 30, 1998 | NINE MONTHS ENDED SEPTEMBER 30, 1997 |
| <C> | <C> |
| \$1,512,942 | \$2,557,818 |
| 7,559,880 | 9,260,908 |
| ----- | ----- |
| 6,046,938 | 6,703,090 |
| 200,962 | 699,686 |
| 320,848 | 219,232 |
| \$5,525,128 | \$5,784,172 |
| ===== | ===== |
| \$ (0.39) | \$ (0.52) |
| ===== | ===== |

</TABLE>

The business combination will result in the issuance of 9,970,900 shares of the Company's Common Stock without receipt of additional consideration by the Company. Giving effect to the issuance of such shares, the number of shares of the Company's Common Stock outstanding as of September 30, 1998 would be 21,194,644.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

3. RESTRICTED CASH

In April 1998, restricted cash totaling \$8,567,000, which supported letters of credit issued to assure repayment of borrowings under a bank line of credit established by Kashtan Petroleum Ltd. ("Kashtan") which operates the Lelyaki Field project, was applied to repay such bank borrowings and related interest. The remaining portion of the restricted cash, totaling \$783,000, was released to the Company free of restrictions in May 1998.

In January 1998, \$350,000 of restricted cash, which had been used to collateralize a bank letter of credit relating to the Gorisht-Kocul Field project, was released.

4. PROPERTY AND EQUIPMENT, NET

Property and equipment, net of accumulated depreciation and impairment at September 30, 1998 and December 31, 1997 included the following:

<TABLE>
<CAPTION>

| | SEPTEMBER 30, 1998 | | | | DECEMBER 31, 1997 |
|--|--------------------|--------------|---------------|-------------|-------------------|
| | ----- | | | | ----- |
| | ACCUMULATED | | | | |
| | ----- | | | | ----- |
| | COST | DEPRECIATION | IMPAIRMENT | NET | NET |
| | ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Electrically enhanced oil recovery ("EEOR") equipment..... | \$ 562,953 | \$(290,885) | \$ -- | \$ 272,068 | \$ 278,044 |
| Oil and gas related equipment..... | 9,473,968 | -- | (2,843,997) | 6,629,971 | 5,504,312 |
| Office furniture, fixtures and equipment and other..... | 1,072,699 | (458,634) | (354,917) | 259,148 | 159,917 |
| | ----- | ----- | ----- | ----- | ----- |
| Property and equipment..... | \$11,109,620 | \$(749,519) | \$(3,198,914) | \$7,161,187 | \$5,942,273 |
| | ===== | ===== | ===== | ===== | |

=====
</TABLE>

Oil and gas related equipment includes new or refurbished drilling rigs and related equipment, substantially all of which the Company now intends to mobilize in the Republic of Georgia. Much of the equipment was originally planned to be used in the Maykop Field, Republic of Adygea, Russian Federation, but following extended delays in resolving operating arrangements with the entity developing that project, the Company recorded an impairment of \$2,844,000 at December 31, 1997, which represented the difference between the book value of the rigs and related equipment and their estimated fair value.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

5. OIL AND GAS PROPERTIES, NET

The Company has acquired interests in oil and gas properties through joint ventures and joint operating arrangements. A summary of the Company's oil and gas properties at September 30, 1998 and December 31, 1997 is set out below:

<TABLE>

<CAPTION>

| | SEPTEMBER 30, 1998 | | | | | DECEMBER |
|---|--------------------|--------------|--------------|-----------|--------------|--------------|
| 31, | | | | | | 1997 |
| | REPUBLIC OF | | | | | |
| | GEORGIA | CANADA | USA | OTHER | TOTAL | TOTAL |
| | | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Proved properties.... | \$15,120,327 | \$ 1,475,593 | \$ 1,174,734 | \$ -- | \$17,770,654 | \$ 2,650,327 |
| Unproved properties..... | 10,887,576 | 324,500 | -- | 239,287 | 11,451,363 | 324,500 |
| Less: accumulated depletion and impairment..... | (105,000) | (1,213,274) | (1,174,734) | -- | (2,493,008) | |
| (1,495,853) | | | | | | |
| Total Oil and Gas Properties, net.... | \$25,902,903 | \$ 586,819 | \$ -- | \$239,287 | \$26,729,009 | \$ 1,478,974 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

</TABLE>

Oil and gas properties obtained in connection with the acquisition of CEI includes \$15,120,000 of properties in the full cost pool and \$10,888,000 of unevaluated properties. The Ninotsminda Field includes seven producing wells and since February 1996 has been operated under the terms of a production sharing contract ("PSC") between NOC and the Republic of Georgia represented by the state oil company, Georgian Oil. Unproved properties in the Republic of Georgia include other license areas within the Ninotsminda PSC as well as another exploration area referred to as the Nazvrevi block operated under the terms of a PSC between the Company's wholly owned subsidiary, CanArgo Nazvrevi Limited, and the Republic of Georgia.

During the first quarter of 1997, the Company purchased a 60% interest in a heavy oil property in the Sylvan Lake area in Alberta, Canada for approximately \$1,009,000. One new well was successfully drilled during the 1997 third quarter, and was prepared for installation of the Company's EEOR equipment. The Sylvan Lake project includes a total of four producing wells. During the nine months ended September 30, 1998, the Company recognized writedowns aggregating \$900,000 on its oil and gas properties in the Sylvan Lake project as a result of a decline of heavy oil prices and the application of the quarterly full cost ceiling test. The writedowns relate to proved properties.

Unproved properties and associated costs not currently being amortized and included in oil and gas properties were \$11,451,000 and \$324,500 at September 30, 1998 and December 31, 1997 respectively, \$324,500 of which relates to the Sylvan Lake Field. The Sylvan Lake Field is expected to be evaluated over the next 15 months, and if no proved reserves are added, those properties could result in additional impairment. All other unproved properties are expected to be evaluated over the next five years.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUEDNINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

6. INVESTMENTS IN AND ADVANCES TO OIL AND GAS VENTURES

The Company has acquired interests in oil and gas ventures through less than

majority interests in corporate and corporate-like entities. A summary of the Company's net investment in and advances to oil and gas ventures as of September 30, 1998 and December 31, 1997 is set out below:

<TABLE>

<CAPTION>

| | SEPTEMBER 30, 1998 | DECEMBER 31, 1997 |
|--|-----------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Ukraine -- Stynawske Field, Boryslaw | | |
| Through 45% ownership of Boryslaw Oil Company..... | \$5,361,531 | \$5,386,707 |
| Ukraine -- Lelyaki Field, Pryluky Region | | |
| Through an effective 40.5% ownership of Kashtan | | |
| Petroleum Ltd..... | -- | -- |
| Adygea, Russian Federation -- Maykop Field | | |
| Through 37% ownership in Intergas JSC..... | -- | -- |
| Albania -- Gorisht-Kocul Field | | |
| Through 50% ownership of joint venture..... | -- | -- |
| | ----- | ----- |
| Total Investments In and Advances to Oil and Gas | | |
| Ventures, Net of Equity Loss and Impairment..... | \$5,361,531 | \$5,386,707 |
| | ===== | ===== |

</TABLE>

As of September 30, 1998, the Company had remaining net investments in and advances to oil and gas ventures totaling \$5,362,000, all of which relate to Boryslaw Oil Company ("BOC"), the entity holding the license to develop the Stynawske Field, for which development operations have not yet begun. Included are advances to BOC totaling \$1,635,000 at September 30, 1998 and \$1,508,000 at December 31, 1997. Such advances may be recoverable only from future revenue of or payments from future participants in the venture, if any.

Based on its analysis of initial Lelyaki Field development efforts completed in the fourth quarter of 1997, the Company concluded that the Lelyaki Field would not support a successful commercial development. As a result, the Company recorded an impairment charge totaling \$9,108,000. In addition, the Company recognized a loss in 1997 of \$2,080,000 reflecting its equity in the loss of Kashtan. The Company believes that it has no further obligation to fund any operations of Kashtan.

Because of extended delays in resolving operating arrangements and other matters associated with Intergas JSC ("Intergas"), the entity developing the Maykop Field project, the Company during the fourth quarter of 1997 recorded an impairment for the entire amount of its investment in and advances to Intergas of \$5,258,000. In addition, the Company recognized a loss in 1997 of \$851,000, reflecting its equity in the loss of Intergas. The Company believes that it has no further obligation to fund any operations of Intergas.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

6. INVESTMENTS IN AND ADVANCES TO OIL AND GAS VENTURES -- (CONTINUED)

In March 1997, the Company declared the political unrest in Albania to be a force majeure with respect to the Gorisht-Kocul project and suspended development activities. Due to the extended period that the force majeure condition has continued and the absence of any indication of an imminent termination of that condition, the Company during the fourth quarter of 1997

recorded an impairment for the entire amount of its investment in and advances to the Gorisht-Kocul joint venture of \$1,370,000. The Company also recognized a \$433,000 loss in 1997 as its equity in the loss of that joint venture. At September 30, 1998, the force majeure condition remained in effect.

The Company's investments in and advances to oil and gas ventures are essentially unevaluated properties. At September 30, 1998 and December 31, 1997, there were no material operations or assets (other than unevaluated properties) of entities being accounted for using the equity method. Accordingly, no other separate financial information has been presented.

7. DUE TO AFFILIATED ENTITY

The loan from Terrenex Acquisition Corporation of \$339,000 is due on demand and is non-interest bearing.

8. ACCRUED LIABILITIES

Accrued liabilities at September 30, 1998 and December 31, 1997 included the following:

<TABLE>

<CAPTION>

| | SEPTEMBER 30, 1998 | DECEMBER 31, 1997 |
|---|-----------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Compensation, including related taxes..... | \$ 53,780 | \$ 337,767 |
| Professional fees..... | 236,037 | 276,500 |
| Termination costs..... | -- | 405,833 |
| Effective guarantee of Kashtan obligations..... | -- | 8,280,000 |
| Close down costs -- Kashtan project..... | 149,182 | 690,622 |
| Management fees..... | 142,000 | -- |
| Taxes..... | 61,000 | -- |
| Interest..... | 198,484 | -- |
| Contingent charges..... | 445,417 | -- |
| Oilfield related equipment..... | 10,000 | 268,000 |
| Other..... | 12,287 | 67,886 |
| | ----- | ----- |
| | \$1,308,187 | \$10,326,608 |
| | ===== | ===== |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

8. ACCRUED LIABILITIES -- (CONTINUED)

At September 30, 1998 the contingent charges consists of charges for goods and services billed to NOC by its non-controlling shareholder which have not yet been agreed to by NOC.

At September 30, 1998 management fees consists of charges for services provided to NOC by its non-controlling shareholder.

9. LONG TERM DEBT

<TABLE>

<CAPTION>

| | SEPTEMBER 30, 1998 | DECEMBER 31, 1997 |
|--------------|-----------------------|----------------------|
| <S> | <C> | <C> |
| Advance..... | \$220,500 | \$ -- |
| Loan..... | 675,000 | -- |
| | ----- | ----- |
| | \$895,500 | \$ -- |
| | ===== | ===== |

</TABLE>

The advances, made by NOC's non-controlling shareholder to NOC, bears no interest unless it is not repaid by June 30, 2000, at which time it would begin to bear interest at 15% per anum until repayment.

The loan from NOC's non-controlling shareholder to NOC bears interest at a rate of 10% per anum and is repayable out of surplus funds of NOC as and when available.

10. STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

| | COMMON STOCK | | | | |
|---|-----------------------------------|--------------|-----------------------|----------------|--------|
| | NUMBER OF SHARES ISSUED AND | | ADDITIONAL PAID-IN | ACCUMULATED | TOTAL |
| STOCKHOLDERS' | ISSUABLE | PAR VALUE | CAPITAL | DEFICIT | EQUITY |
| --- | ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Balance, December 31, 1997.... | 22,447,489 | \$ 2,244,749 | \$ 82,040,156 | \$(57,505,649) | |
| \$26,779,256 | | | | | |
| Net loss..... | -- | -- | -- | (4,790,481) | |
| (4,790,481) | | | | | |
| --- | ----- | ----- | ----- | ----- | ----- |
| -- | 22,447,489 | \$ 2,244,749 | \$ 82,040,156 | \$(62,296,130) | |
| \$21,988,775 | | | | | |
| One-for-two reverse split of the shares of the Company's Common Stock (July 15, 1998)..... | (11,223,745) | (1,122,375) | 1,122,375 | -- | |
| -- | | | | | |
| Shares issuable without payment of additional consideration..... | 9,970,900 | 997,090 | 18,702,910 | -- | |
| 19,700,000 | | | | | |
| --- | ----- | ----- | ----- | ----- | ----- |
| -- | 21,194,644 | \$ 2,119,464 | \$101,865,441 | \$(62,296,130) | |
| Balance, September 30, 1998... | | | | | |
| \$41,688,775 | | | | | |
| | ===== | ===== | ===== | ===== | |

=====
</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

10. STOCKHOLDERS' EQUITY -- (CONTINUED)

The business combination will result in the issuance of 9,970,900 shares of the Company's Common Stock determined as follows:

| <TABLE> <CAPTION> COMMON STOCK RESERVED FOR ISSUANCE TO CEI SECURITY HOLDERS (POST 1:2 REVERSE SPLIT) | |
|--|-------------|
| | # OF SHARES |
| - - - - - | - - - - - |
| <S> | <C> |
| Exchangeable Shares issued by CEI..... | 8,543,014 |
| Special Warrants issued by CEI..... | 1,427,886 |
| | - - - - - |
| Total CEI Exchangeable Shares Issued and Reserved as of September 30, 1998..... | 9,970,900 |
| | ===== |

</TABLE>

The Exchangeable Shares are securities issued by CEI that are exchangeable generally at the option of the holders for shares of the Company's Common Stock on a share-for-share basis and entitle the holders to dividends and other rights economically equivalent to those to which holders of the Company's Common Stock are entitled. Through contractual arrangements, holders of Exchangeable Shares have the right to direct votes at meetings of stockholders of the Company commensurate with the number of shares of the Company's Common Stock such holders, respectively, have the right to receive upon exchange of the Exchangeable Shares. As a result of such contractual arrangements, the Exchangeable Shares represent the same rights to dividends and rights upon liquidation and generally have the same voting rights as shares of the Company's Common Stock.

PREFERRED STOCK

The accompanying financial statements do not give effect to the issuance of one hundred shares (the "Preferred Shares") of Series Voting Preferred Stock to the Montreal Trust Company of Canada (the "Trustee") under the Voting, Support and Exchange Trust Agreement entered into among the Company, CEI and the Trustee. The Preferred Shares embody the right to (i) the voting power of the holders of unexchanged Exchangeable Shares following the exchange thereof for shares of the Company's Common Stock and (ii) the right to receive an aggregate of \$100 upon redemption at the rate of \$1.00 per Preferred Share following the exchange of all outstanding Exchangeable Shares.

The Preferred Shares will be stripped of their voting power proportionately as Exchangeable Shares are exchanged for shares of the Company's Common Stock. When fully divested of voting rights through the exchange of all Exchangeable Shares, the Preferred Shares can be redeemed by the Company for nominal consideration. Thus, the Preferred Shares do not have substance for accounting purposes.

OPTIONS

On August 17, 1994, options to purchase 200,000 shares (400,000 shares pre-Reverse Split) of the Company's Common Stock were issued to various individuals who were

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

10. STOCKHOLDERS' EQUITY -- (CONTINUED)

serving or were expected in the future to serve the Company as officers, directors, employees, consultants and advisors (the "1994 Plan"). The options are exercisable at an exercise price of \$3.00 and are only exercisable at the time or within six months after services are rendered by such individuals. 88,000 of the options remained outstanding at September 30, 1998, all of which expire August 16, 1999.

Pursuant to the 1995 Long-Term Incentive Plan (the "1995 Plan") adopted by the Company in February 1996, 750,000 shares (1,500,000 shares pre-Reverse Split) of the Company's Common Stock have been authorized for possible issuance under the 1995 Plan. Stock options granted under the 1995 Plan may be either incentive stock options or non-qualified stock options. Options expire on such date as is determined by the committee administering the 1995 Plan, except that incentive stock options may expire no later than 10 years from the date of grant. Pursuant to the 1995 Plan, a specified number of stock options exercisable at the then market price are granted annually to non-employee directors of the Company, which become 100% vested six months from the date of grant. Stock appreciation rights entitle the holder to receive payment in cash or Common Stock equal in value to the excess of the fair market value of a specified number of shares of Common Stock on the date of exercise over the exercise price of the stock appreciation right. No stock appreciation rights have been granted through September 30, 1998. The exercise price and vesting schedule of stock appreciation rights are determined at the date of grant. 544,500 of the options remained outstanding at September 30, 1998.

Pursuant to the terms of an Amended and Restated Combination Agreement between the Company and CEI (the "Combination Agreement"), on July 15, 1998 each stock option granted under CEI's Stock Option Plan ("CEI Plan") to purchase a CEI Common Share was converted into an option to purchase 0.8 shares of the Company's Common Stock. Pursuant to the CEI Plan, which has been adopted by the Company, a total of 988,000 shares of the Company's Common Stock have been authorized for issuance under the CEI Plan of which 848,000 options were outstanding at September 30, 1998. Stock options granted under the CEI Plan expire on such date as is determined by the committee administering the CEI Plan, except that the term of stock options may not exceed 10 years from the date of grant.

The purpose of the Company's Stock Option Plans is to further the interest of the Company by enabling officers, directors, employees, consultants and advisors of the Company to acquire an interest in the Company by ownership of its stock through the exercise of stock options granted under its various Stock Option Plans.

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUED

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)

10. STOCKHOLDERS' EQUITY -- (CONTINUED)

A summary of the status of stock options granted under the 1994 Plan, the 1995 Plan and the CEI Plan, restated to give effect to the Reverse Split, is as follows:

<TABLE>

<CAPTION>

SHARES ISSUABLE

WEIGHTED

| | SHARES AVAILABLE FOR ISSUE | UNDER OUTSTANDING OPTIONS | AVERAGE EXERCISE PRICE |
|---------------------------------------|-------------------------------|------------------------------|---------------------------|
| <S> | <C> | <C> | <C> |
| Balance at August 31, 1995.... | 0 | 200,000 | \$ 3.00 |
| 1995 Plan Authorization.... | 750,000 | | |
| Options: | | | |
| Granted at market..... | (15,000) | 15,000 | \$ 7.68 |
| Exercised..... | -- | (26,000) | \$ 3.00 |
| | ----- | ----- | |
| Balance at August 31, 1996.... | 735,000 | 189,000 | \$ 3.38 |
| Options: | | | |
| Granted at market..... | (190,750) | 190,750 | \$14.50 |
| Granted at a premium.... | (222,500) | 222,500 | \$17.98 |
| Exercised..... | -- | (6,000) | \$ 3.00 |
| | ----- | ----- | |
| Balance at December 31, 1996..... | 321,750 | 596,250 | \$12.38 |
| Options: | | | |
| Granted at market..... | (18,500) | 18,500 | \$ 8.90 |
| Granted at a premium.... | (77,500) | 77,500 | \$10.54 |
| Exercised..... | -- | (52,000) | \$ 3.00 |
| Canceled..... | 63,084 | (63,084) | \$14.54 |
| | ----- | ----- | |
| Balance at December 31, 1997..... | 288,834 | 577,166 | \$12.64 |
| CEI Plan Authorization..... | 988,000 | | |
| Outstanding CEI Plan Options..... | (848,000) | 848,000 | \$ 1.85 |
| Options: | | | |
| Granted at market..... | (447,500) | 447,500 | \$ 1.25 |
| Canceled..... | 364,166 | (364,166) | \$15.75 |
| Canceled..... | -- | (28,000) | \$ 3.00 |
| | ----- | ----- | |
| Balance at September 30, 1998..... | 345,500 | 1,480,500 | \$ 2.43 |
| | ===== | ===== | |

</TABLE>

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CANARGO ENERGY CORPORATION

NOTES TO UNAUDITED CONSOLIDATED
CONDENSED FINANCIAL STATEMENTS -- CONTINUEDNINE MONTHS ENDED SEPTEMBER 30, 1998 AND SEPTEMBER 30, 1997
(UNAUDITED)10. STOCKHOLDERS' EQUITY -- (CONTINUED)
WARRANTS

Pursuant to the terms of the Combination Agreement, holders of CEI Stock Purchase Warrants have the right to purchase CEI Exchangeable Shares which are exchangeable generally at the option of the holder for shares of the Company's Common Stock on a share-for-share basis. As of September 30, 1998, a total of 1,097,511 CEI Stock Purchase Warrants were outstanding. A summary of the CEI Stock Purchase Warrants is as follows:

<TABLE>

<CAPTION>

| NUMBER OF WARRANTS | EXERCISE PRICE IN CANADIAN DOLLARS | EXPIRATION DATE |
|-----------------------|---------------------------------------|-----------------|
| ----- | ----- | ----- |
| <C> | <C> | <S> |

| | | |
|---------|----------|------------------|
| 164,008 | C\$2.750 | April 30, 1999 |
| 32,000 | C\$2.875 | July 31, 1999 |
| 901,503 | C\$3.250 | November 1, 1999 |

- -----
1,097,511
=====

</TABLE>

11. NET LOSS PER COMMON SHARE

Effective December 31, 1997, the Company adopted SFAS No. 128 Earnings Per Share. Basic and diluted net loss per common share for the periods ended September 30, 1998 and September 30, 1997 are based on the weighted average number of common shares outstanding during those periods. The weighted average numbers of shares issued and issuable without receipt of additional consideration for the nine month periods ended September 30, 1998 and 1997 is 14,072,572 and 11,200,757, respectively. The weighted average number of common shares outstanding includes 8,543,014 and 0 Exchangeable Shares issued in connection with the Transaction, respectively, and excludes 1,480,500 and 603,250 shares issuable upon exercise of options, respectively, because they are anti-dilutive.

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CONSOLIDATED FINANCIAL STATEMENTS

CANARGO OIL & GAS INC.
(FORMERLY CANARGO ENERGY INC.)

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CANARGO OIL & GAS INC.

CONSOLIDATED BALANCE SHEET
(SEE BASIS OF PRESENTATION -- NOTE 1)
(STATED IN U.S. DOLLARS)

<TABLE>
<CAPTION>

| | JUNE 30, 1998 |
|---|------------------|
| | ----- |
| | (UNAUDITED) |
| | <C> |
| <S> | |
| ASSETS | |
| Current | |
| Cash..... | \$ 935,443 |
| Accounts receivable..... | 2,116,286 |
| Prepaid expenses..... | 23,511 |
| Inventory..... | 20,405 |
| | ----- |
| | \$ 3,095,645 |
| Oil and gas properties [note 5]..... | 9,061,436 |
| | ----- |
| | \$12,157,081 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| Current | |
| Accounts payable and accrued liabilities..... | \$ 3,051,742 |
| Taxes payable..... | 61,000 |
| | ----- |
| | \$ 3,112,742 |
| Long term debt [note 6]..... | 895,500 |

| | |
|--|--------------|
| Non-controlling interest..... | 3,437,929 |
| | ----- |
| | \$ 7,446,171 |
| | ----- |
| CONTINGENCIES [NOTES 7 AND 8] | |
| SHAREHOLDERS' EQUITY | |
| Share capital and special warrants [note 7]..... | \$ 5,701,384 |
| Deficit..... | (990,474) |
| | ----- |
| | \$ 4,710,910 |
| | ----- |
| | \$12,157,081 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT
(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

| | |
|--|---|
| | SIX MONTHS ENDED JUNE 30, 1998 |
| | ----- |
| | (UNAUDITED) |
| <S> | <C> |
| REVENUE | |
| Oil..... | \$ 992,952 |
| Interest..... | 46,979 |
| | ----- |
| | \$ 1,039,931 |
| | ----- |
| EXPENSES | |
| Operating costs..... | \$ 771,652 |
| General and administration..... | 703,652 |
| Depletion..... | 527,676 |
| Interest..... | 39,020 |
| | ----- |
| | \$ 2,042,000 |
| | ----- |
| Loss before non-controlling interest..... | \$(1,002,069) |
| Non-controlling interest..... | 267,422 |
| | ----- |
| LOSS FOR THE PERIOD..... | \$ (734,647) |
| DEFICIT -- BEGINNING OF PERIOD..... | \$ (255,827) |
| | ----- |
| DEFICIT -- END OF PERIOD..... | \$ (990,474) |
| | ===== |
| BASIC AND FULLY DILUTED LOSS PER SHARE..... | \$ (0.07) |
| | ----- |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING DURING PERIOD..... | 10,438,391 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

CONSOLIDATED STATEMENT OF CASH FLOWS
(STATED IN U.S. DOLLARS)<TABLE>
<CAPTION>

| | SIX MONTHS ENDED JUNE 30, 1998 ----- (UNAUDITED) <C> |
|--|--|
| <S> | |
| CASH PROVIDED BY (USED IN) | |
| OPERATING ACTIVITIES | |
| Loss for the period..... | \$ (734,647) |
| Items not requiring cash | |
| Depletion..... | 527,676 |
| Non-controlling interest..... | (267,422) |
| | ----- |
| Funds from operations..... | \$ (474,393) |
| Net change in non-cash working capital related to operating activities..... | 522,401 |
| | ----- |
| | \$ 48,008 |
| | ----- |
| INVESTING ACTIVITIES | |
| Additions to capital assets..... | \$(2,527,655) |
| | ----- |
| | \$(2,527,655) |
| | ----- |
| FINANCING ACTIVITIES | |
| Contribution from non-controlling interest..... | \$ 1,820,000 |
| Share issue costs..... | (238,358) |
| | ----- |
| | \$ 1,581,642 |
| | ----- |
| INCREASE (DECREASE) IN CASH..... | \$ (898,005) |
| Cash position, beginning of period..... | \$ 1,833,448 |
| | ----- |
| CASH POSITION, END OF PERIOD..... | \$ 935,443 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED
FINANCIAL STATEMENTSSIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

1. BASIS OF PRESENTATION

Prior to July 1, 1997, CanArgo Oil & Gas Inc. (formerly CanArgo Energy Inc.) carried on business under the name Money Works Inc. Money Works Inc. was

incorporated under the Alberta Business Corporations Act. Effective July 1, 1997, Money Works Inc. acquired all of the outstanding common shares of CanArgo Ltd. by issuing a total of 8,276,250 common shares from treasury (see note 4), and changed its name to CanArgo Energy Inc. ("the Corporation"). This resulted in the former shareholders of CanArgo Ltd. acquiring control of Money Works Inc. Accordingly, this transaction has been accounted for as a reverse takeover of the Corporation and the Consolidated Balance Sheet includes the assets and liabilities of CanArgo Ltd. at their carrying values together with the net assets of Money Works Inc. acquired at their ascribed fair values. The financial statements of the Corporation are a continuation of the financial statements of CanArgo Ltd., the acquirer, for accounting purposes.

CanArgo Ltd. was incorporated on March 4, 1997 with nominal share capital for the purpose of holding certain shareholders' interest aggregating 55.9% of the shares of Ninotsminda Oil Company Limited ("NOC"). There was no change in the individual shareholders' effective interest in NOC as a result of the formation of CanArgo Ltd.

NOC is a Cypriot company specializing in the exploration and development of oil and gas properties in the Republic of Georgia. NOC operates under the terms of a Production Sharing Contract ("PSC") signed February 15, 1996 between NOC and the Republic of Georgia represented by the state oil company, Georgian Oil. Under the terms of the PSC, NOC is responsible for the costs associated with the project, which is operated on behalf of NOC by the local operating company, Georgian British Oil Company ("Georgian Oil"). Georgian Oil is responsible for the costs associated with site restoration and abandonment, royalties and all state taxes. The PSC expires in December 2019 and provides for a five-year extension. While areas containing field developments are not subject to relinquishment, other areas are subject to relinquishment after 5, 10, 15 and 20 years after the date of issue of the license. Currently, the Ninotsminda field is the only producing field in this license.

Production from the Ninotsminda field commenced in the early part of 1996, and during 1996 approximately 515,000 barrels of oil were produced. Under the terms of the PSC, Georgian Oil currently takes the first 96.4 tons per day ("determined production") of production, after which all production is shared. The level of determined production will change in accordance with the terms of the agreement. After determined production, NOC receives up to 50% of production for cost recovery. Remaining production after cost recovery is then allocated as to 30% to NOC and as to 70% to Georgian Oil.

To date, NOC has sold all of its production to one international buyer at prices related to the world market price for Brent crude, with payment in US dollars into NOC's bank account in Cyprus.

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED

SIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

1. BASIS OF PRESENTATION -- (CONTINUED)

NOC is in an early stage of operations and is facing challenges typical of doing business in the former Soviet Union. Neither NOC nor the Corporation is currently in a position to finance all working capital or capital investment requirements through their own operations and therefore will require additional external financing.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation follows accounting principles generally accepted in Canada. The

significant accounting policies are noted below.

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Corporation's wholly owned subsidiaries CanArgo Ltd. and CanArgo Nazvrevi Limited and its 55.9% owned subsidiary, NOC. The Corporation's interest in NOC was contributed by the CanArgo Ltd. shareholders. As there was no substantive change in the ownership of the NOC shares arising from the transfer, the Corporation has recorded its investment at the historic costs of NOC to the shareholders.

B) INVENTORY

Materials, supplies and spare parts held for use in the oil field and inventories of petroleum products held for sale are recorded at the lower of average cost and net realizable value.

C) OIL AND GAS PROPERTIES

The Corporation follows the full cost method of accounting for exploration and development expenditures wherein all costs related to the exploration for and the development of oil and gas reserves are capitalized. These costs include lease acquisition costs, geological and geophysical expenses, carrying charges of non-producing properties, costs of drilling and completing wells and oil and gas production equipment and that portion of general and administrative expense applicable to these activities. Proceeds received from the disposal of properties are normally credited against accumulated costs unless this would result in a change in the depletion rate by more than 20%, in which case a gain or loss is computed and reflected in the statement of operations.

Depletion of exploration and development costs and production equipment is provided on the unit-of-production method based upon estimated proved oil and gas reserves, as determined by independent engineers.

The Corporation carries its oil and gas properties at the lower of capitalized cost and net recoverable amount. Net recoverable amount is future net revenues from proved reserves plus unproved properties at cost less any impairment. Future net revenues are determined using unit prices and production and overhead costs, financing charges and income taxes that will be incurred in earning these revenues.

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED
FINANCIAL STATEMENTS -- CONTINUED

SIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

D) FOREIGN CURRENCY TRANSLATION

These financial statements are presented in United States dollars. Monetary amounts denominated in a foreign currency are translated to United States dollars at the exchange rate in effect at the balance sheet date. Revenue and expense items are translated at the average exchange rate for the period. Exchange gains and losses resulting from the translation of foreign currency amounts are included in or charged to income for the year.

E) FINANCIAL INSTRUMENTS

Financial instruments of the Corporation consist of cash, accounts receivable,

accounts payable and long term debt. As at June 30, 1998 there are no significant differences between their carrying values and their estimated market values.

F) INCOME TAXES

Georgian Oil is responsible for all state taxes in the Republic of Georgia. The undistributed earnings of foreign investees are considered to be permanently invested for their continuing operations; accordingly, no provisions are made for taxes which would become payable upon the distribution of such earnings to the parent company.

G) MEASUREMENT UNCERTAINTY

The amount recorded for depletion of oil and gas properties is based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

3. CONTRIBUTING OF SHARES OF NOC

Effective June 30, 1997, the shareholders of CanArgo Ltd. contributed their collective 55.9% interest in NOC for shares in a common control transaction. The contribution is summarized as follows:

| <TABLE> | |
|---|--------------|
| <S> | |
| <C> | |
| NET ASSETS CONTRIBUTED: | |
| Current assets, including \$492,295 cash..... | \$ 1,291,195 |
| Capital assets..... | 4,748,422 |
| Current liabilities..... | (777,834) |
| Long term debt..... | (675,000) |
| Non-controlling interest..... | (1,399,783) |
| | ----- |
| SHARES ISSUED: 8,275,250 common shares..... | \$ 3,187,000 |
| | ===== |
| </TABLE> | |

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED
FINANCIAL STATEMENTS -- CONTINUED

SIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

4. ACQUISITION OF CANARGO LTD.

Effective July 1, 1997, the Corporation acquired all of the outstanding shares of CanArgo Ltd., a privately owned company. This transaction has been accounted for as a reverse takeover as described in Note 1.

The acquisition is summarized as follows:

| <TABLE> | |
|--|-----------|
| <S> | |
| <C> | |
| NET ASSETS OF CANARGO ENERGY INC. (FORMERLY MONEY WORKS INC.) ACQUIRED: | |
| Current assets, including \$2,726 cash..... | \$ 44,108 |
| Current liabilities..... | (12,133) |
| | ----- |

\$ 31,975

CONSIDERATION:

| | |
|------------------------------|-----------|
| 1,708,640 common shares..... | \$ 31,975 |
| | ===== |

</TABLE>

5. OIL AND GAS PROPERTIES

<TABLE>

<CAPTION>

JUNE 30, 1998

(UNAUDITED)

<S>

<C>

| | |
|-----------------------------|--------------|
| Oil and gas properties..... | \$10,887,172 |
| Accumulated Depletion..... | (1,825,736) |

\$ 9,091,436

=====

</TABLE>

General and administrative expenses of \$535,363 were capitalized during the six months ended June 30, 1998.

6. LONG TERM DEBT

<TABLE>

<CAPTION>

JUNE 30, 1998

(UNAUDITED)

<S>

<C>

| | |
|--------------|-----------|
| Advance..... | \$220,500 |
| Loan..... | 675,000 |

\$895,500

=====

</TABLE>

The advance from non-controlling interest to NOC bears no interest unless it is not repaid by June 30, 2000, at which time it would bear interest at 15% until repayment.

The loan from non-controlling interest to NOC bears interest at a rate of 10% and is repayable out of surplus funds of NOC as and when available.

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED
FINANCIAL STATEMENTS -- CONTINUED

SIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

7. SHARE CAPITAL AND SPECIAL WARRANTS

AUTHORIZED

Unlimited number of voting common shares
Unlimited number of first preferred shares
Unlimited number of second preferred shares

<TABLE>

<CAPTION>

ISSUED COMMON SHARES

NUMBER

AMOUNT

<S>

<C>

<C>

| | | |
|--|------------|-------------|
| Balance, December 31, 1997..... | 10,438,391 | \$3,917,465 |
| Share issue costs..... | | (238,358) |
| Balance, June 30, 1998..... | | 3,679,107 |
| SPECIAL WARRANTS | | |
| Special warrants issued..... | 1,636,597 | \$2,520,359 |
| Issue costs..... | -- | (498,082) |
| Balance, December 31, 1997 and June 30, 1998..... | 1,636,597 | \$2,022,277 |
| WARRANTS ISSUED AND BALANCE, DECEMBER 31, 1997 AND JUNE 30, 1998..... | 681,760 | \$ -- |
| TOTAL SHARE CAPITAL AND SPECIAL WARRANTS, DECEMBER 31, 1997..... | | 5,701,389 |

</TABLE>

On November 3, 1997, the Corporation closed a private placement of 1,636,597 special warrants at a price of Canadian \$2.20 per special warrant. Each special warrant is convertible into one common share of the Corporation and one half of one warrant. Each full warrant is exercisable into one common share at a price of Canadian \$2.60 per share through to November 1, 1999.

In conjunction with the special warrants placement, 681,760 warrants were issued. Each warrant is exercisable into one common share with 455,010 being exercisable at a price of Canadian \$2.20, 250,000 warrants of which expire on June 30, 1998 and 205,010 warrants of which expire April 30, 1999, and 226,750 being exercisable at a price of Canadian \$2.60 and expiring on November 1, 1999.

If the Corporation has not obtained a receipt for a final prospectus indicating the qualification of these securities in each relevant jurisdiction by February 28, 1998 then each special warrant will entitle the holder to receive an additional 0.1 common share and 0.05 warrant without payment of additional consideration.

INCENTIVE STOCK OPTION PLAN

During the period ended December 31, 1997, 1,035,000 common share options were granted; none were exercised. At December 31, 1997, options exercisable between 1998 and 2002 were outstanding to purchase 1,035,000 common shares at a price of \$2.20 per share.

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CANARGO OIL & GAS INC.

NOTES TO UNAUDITED CONSOLIDATED
FINANCIAL STATEMENTS -- CONTINUED

SIX MONTHS ENDED JUNE 30, 1998
(UNAUDITED)

8. SUBSEQUENT EVENTS

On February 2, 1998, the Corporation entered into an agreement with Fountain Oil Incorporated ("Fountain") under which a business combination would be effected through an exchange of shares. Each common share of the Corporation is exchangeable into 0.8 (1.6 preReverse Split) common shares of Fountain. This

business combination is subject to regulatory and shareholder approval.

9. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IN THE UNITED STATES

The Corporation's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada, which in the case of the Corporation at June 30, 1998, conforms in all material respects with United States GAAP.

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CONSOLIDATED FINANCIAL STATEMENTS

CANARGO OIL & GAS INC.
(FORMERLY CANARGO ENERGY INC.)

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AUDITORS' REPORT

To the Directors of
CanArgo Oil & Gas Inc.

We have audited the consolidated balance sheet of CanArgo Oil & Gas Inc. (formerly CanArgo Energy Inc.) as at December 31, 1997 and the consolidated statements of operations and deficit and cash flows for the six-month period then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1997 and the results of its operations and the changes in its financial position for the six month period then ended in accordance with accounting principles generally accepted in Canada.

<TABLE>

<S>

Calgary, Canada
February 18, 1998
</TABLE>

<C>

/s/ Ernst & Young
Ernst & Young
Chartered Accountants

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CANARGO OIL & GAS INC.

CONSOLIDATED BALANCE SHEET
(SEE BASIS OF PRESENTATION -- NOTE 1)
(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

DECEMBER 31,

| | 1997 |
|--|-------------|
| <S> | <C> |
| ASSETS | |
| Current | |
| Cash..... | \$1,833,448 |
| Accounts receivable..... | 514,513 |
| Prepaid expenses..... | 53,668 |
| Inventory..... | 20,405 |
| | ----- |
| | \$2,422,034 |
| Oil and gas properties [note 5]..... | 7,061,457 |
| | ----- |
| | \$9,483,491 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| Current | |
| Accounts payable and accrued liabilities..... | \$ 957,725 |
| Taxes payable..... | 61,000 |
| | ----- |
| | \$1,018,725 |
| Long term debt [note 6]..... | 895,500 |
| Non-controlling interest..... | 1,885,351 |
| | ----- |
| | \$3,799,576 |
| | ----- |
| CONTINGENCIES [NOTES 7 AND 8] | |
| SHAREHOLDERS' EQUITY | |
| Share capital and special warrants [note 7]..... | \$5,939,742 |
| Deficit..... | (255,827) |
| | ----- |
| | \$5,683,915 |
| | ----- |
| | \$9,483,491 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT
(STATED IN U.S. DOLLARS)

<TABLE>
<CAPTION>

| | SIX MONTHS ENDED DECEMBER 31, 1997 |
|---------------------------------|---|
| <S> | <C> |
| REVENUE | |
| Oil..... | \$ 1,324,114 |
| Interest..... | 22,681 |
| | ----- |
| | \$ 1,346,795 |
| | ----- |
| EXPENSES | |
| Operating costs..... | \$ 790,287 |
| General and administration..... | 386,397 |
| Depletion..... | 555,960 |

| | |
|---|--------------|
| Interest..... | 34,410 |
| | ----- |
| | \$ 1,767,054 |
| | ----- |
| Loss before non-controlling interest..... | \$ (420,259) |
| Non-controlling interest..... | 164,432 |
| | ----- |
| LOSS FOR THE PERIOD..... | \$ (255,827) |
| DEFICIT -- BEGINNING OF PERIOD..... | -- |
| | ----- |
| DEFICIT -- END OF PERIOD..... | \$ (255,827) |
| | ===== |
| BASIC AND FULLY DILUTED LOSS PER SHARE..... | \$ (0.03) |
| | ----- |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING DURING PERIOD..... | \$10,210,641 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

CONSOLIDATED STATEMENT OF CASH FLOWS
(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

SIX MONTHS ENDED
DECEMBER 31, 1997

<S>

<C>

| | |
|---|---------------|
| CASH PROVIDED BY (USED IN) | |
| OPERATING ACTIVITIES | |
| Loss for the period..... | \$ (255,827) |
| Items not requiring cash | |
| Depletion..... | 555,960 |
| Non-controlling interest..... | (164,432) |
| | ----- |
| Funds from operations..... | \$ 135,701 |
| Net change in non-cash working capital related to operating activities..... | 480,454 |
| | ----- |
| | \$ 616,155 |
| | ----- |
| INVESTING ACTIVITIES | |
| Contribution of NOC assets, net of cash..... | \$(2,694,705) |
| Acquisition of Money Works Inc., net of cash..... | (29,249) |
| Additions to capital assets..... | (2,868,995) |
| | ----- |
| | \$(5,592,949) |
| | ----- |
| FINANCING ACTIVITIES | |
| Issue of share capital on contribution of NOC assets..... | \$ 3,187,000 |
| Issue of share capital to acquire Money Works Inc..... | 31,975 |
| Initial share capital issued..... | 100 |
| Contribution from non-controlling interest..... | 650,000 |
| Long term debt..... | 220,500 |
| Issue of share capital..... | 698,390 |
| Issuance of special warrants, net of issue costs..... | 2,022,277 |
| | ----- |
| | \$ 6,810,242 |

| | |
|---|--------------|
| INCREASE IN CASH..... | \$ 1,833,448 |
| Cash position, beginning of period..... | -- |
| CASH POSITION, END OF PERIOD..... | \$ 1,833,448 |
| | ===== |

</TABLE>

See accompanying notes

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (STATED IN U.S. DOLLARS)

1. BASIS OF PRESENTATION

Prior to July 1, 1997, CanArgo Oil & Gas Inc. (formerly CanArgo Energy Inc.) carried on business under the name Money Works Inc. Money Works Inc. was incorporated under the Alberta Business Corporations Act. Effective July 1, 1997, Money Works Inc. acquired all of the outstanding common shares of CanArgo Ltd. by issuing a total of 8,276,250 common shares from treasury (see note 4), and changed its name to CanArgo Energy Inc. ("the Corporation"). This resulted in the former shareholders of CanArgo Ltd. acquiring control of Money Works Inc. Accordingly, this transaction has been accounted for as a reverse takeover of the Corporation and the Consolidated Balance Sheet includes the assets and liabilities of CanArgo Ltd. at their carrying values together with the net assets of Money Works Inc. acquired at their ascribed fair values. The financial statements of the Corporation are a continuation of the financial statements of CanArgo Ltd., the acquirer, for accounting purposes.

CanArgo Ltd. was incorporated on March 4, 1997 with nominal share capital for the purpose of holding certain shareholders' interest aggregating 55.9% of the shares of Ninotsminda Oil Company Limited ("NOC"). There was no change in the individual shareholders' effective interest in NOC as a result of the formation of CanArgo Ltd. These consolidated financial statements reflect the operations of the Corporation from July 1, 1997, the date of commencement of operations, which also coincides with the date of the reverse takeover, when the series of transactions resulting in achieving control over the principal operating asset was culminated.

NOC is a Cypriot company specializing in the exploration and development of oil and gas properties in the Republic of Georgia. NOC operates under the terms of a Production Sharing Contract ("PSC") signed February 15, 1996 between NOC and the Republic of Georgia represented by the state oil company, Georgian Oil. Under the terms of the PSC, NOC is responsible for the costs associated with the project, which is operated on behalf of NOC by the local operating company, Georgian British Oil Company ("Georgian Oil"). Georgian Oil is responsible for the costs associated with site restoration and abandonment, royalties and all state taxes. The PSC expires in December 2019 and provides for a five-year extension. While areas containing field developments are not subject to relinquishment, other areas are subject to relinquishment after 5, 10, 15 and 20 years after the date of issue of the license. Currently, the Ninotsminda field is the only producing field in this license.

Production from the Ninotsminda field commenced in the early part of 1996, and during 1996 approximately 515,000 barrels of oil were produced. Under the terms of the PSC, Georgian Oil currently takes the first 96.4 tons per day ("determined production") of production, after which all production is shared. The level of determined production will change in accordance with the terms of the agreement. After determined production, NOC receives up to 50% of production for cost recovery. Remaining production after cost recovery is then allocated as

to 30% to NOC and as to 70% to Georgian Oil.

To date, NOC has sold all of its production to one international buyer at prices related to the world market price for Brent crude, with payment in US dollars into NOC's bank account in Cyprus.

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED
(STATED IN U.S. DOLLARS)

1. BASIS OF PRESENTATION -- (CONTINUED)

NOC is in an early stage of operations and is facing challenges typical of doing business in the former Soviet Union. Neither NOC nor the Corporation is currently in a position to finance all working capital or capital investment requirements through their own operations and therefore will require additional external financing.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation follows accounting principles generally accepted in Canada. The significant accounting policies are noted below.

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Corporation's wholly owned subsidiaries CanArgo Ltd. and CanArgo Nazvrevi Limited and its 55.9% owned subsidiary, NOC. The Corporation's interest in NOC was contributed by the CanArgo Ltd. shareholders. As there was no substantive change in the ownership of the NOC shares arising from the transfer, the Corporation has recorded its investment at the historic costs of NOC to the shareholders.

B) INVENTORY

Materials, supplies and spare parts held for use in the oil field and inventories of petroleum products held for sale are recorded at the lower of average cost and net realizable value.

C) OIL AND GAS PROPERTIES

The Corporation follows the full cost method of accounting for exploration and development expenditures wherein all costs related to the exploration for and the development of oil and gas reserves are capitalized. These costs include lease acquisition costs, geological and geophysical expenses, carrying charges of non-producing properties, costs of drilling and completing wells and oil and gas production equipment and that portion of general and administrative expense applicable to these activities. Proceeds received from the disposal of properties are normally credited against accumulated costs unless this would result in a change in the depletion rate by more than 20%, in which case a gain or loss is computed and reflected in the statement of operations.

Depletion of exploration and development costs and production equipment is provided on the unit-of-production method based upon estimated proved oil and gas reserves, as determined by independent engineers.

The Corporation carries its oil and gas properties at the lower of capitalized cost and net recoverable amount. Net recoverable amount is future net revenues from proved reserves plus unproved properties at cost less any impairment. Future net revenues are determined using unit prices and production and overhead costs, financing charges and income taxes that will be incurred in earning these revenues.

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED
(STATED IN U.S. DOLLARS)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

D) FOREIGN CURRENCY TRANSLATION

These financial statements are presented in United States dollars. Monetary amounts denominated in a foreign currency are translated to United States dollars at the exchange rate in effect at the balance sheet date. Revenue and expense items are translated at the average exchange rate for the period. Exchange gains and losses resulting from the translation of foreign currency amounts are included in or charged to income for the year.

E) FINANCIAL INSTRUMENTS

Financial instruments of the Corporation consist of cash, accounts receivable, accounts payable and long term debt. As at December 31, 1997 there are no significant differences between their carrying values and their estimated market values.

F) INCOME TAXES

Georgian Oil is responsible for all state taxes in the Republic of Georgia. The undistributed earnings of foreign investees are considered to be permanently invested for their continuing operations; accordingly, no provisions are made for taxes which would become payable upon the distribution of such earnings to the parent company.

G) MEASUREMENT UNCERTAINTY

The amount recorded for depletion of oil and gas properties is based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

3. CONTRIBUTING OF SHARES OF NOC

Effective June 30, 1997, the shareholders of CanArgo Ltd. contributed their collective 55.9% interest in NOC for shares in a common control transaction. The contribution is summarized as follows:

<TABLE>

<S>

<C>

NET ASSETS CONTRIBUTED:

| | |
|---|--------------|
| Current assets, including \$492,295 cash..... | \$ 1,291,195 |
| Capital assets..... | 4,748,422 |
| Current liabilities..... | (777,834) |
| Long term debt..... | (675,000) |
| Non-controlling interest..... | (1,399,783) |

\$ 3,187,000
=====

SHARES ISSUED:

| | |
|------------------------------|--------------|
| 8,275,250 common shares..... | \$ 3,187,000 |
|------------------------------|--------------|

=====

</TABLE>

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED
(STATED IN U.S. DOLLARS)

4. ACQUISITION OF CANARGO LTD.

Effective July 1, 1997, the Corporation acquired all of the outstanding shares of CanArgo Ltd., a privately owned company. This transaction has been accounted for as a reverse takeover as described in Note 1.

The acquisition is summarized as follows:

| <TABLE> | |
|---|-----------|
| <S> | |
| NET ASSETS OF CANARGO ENERGY INC. (FORMERLY MONEY WORKS INC.) ACQUIRED: | |
| Current assets, including \$2,726 cash..... | \$ 44,108 |
| Current liabilities..... | (12,133) |
| | ----- |
| | \$ 31,975 |
| | ----- |
| CONSIDERATION: | |
| 1,708,640 common shares..... | \$ 31,975 |
| | ===== |

</TABLE>

5. OIL AND GAS PROPERTIES

<TABLE>
<CAPTION>

| | | DECEMBER 31, 1997 |
|-----------------------------|--|----------------------|
| <S> | | ----- |
| <C> | | <C> |
| Oil and gas properties..... | | \$7,617,417 |
| Accumulated Depletion..... | | (555,960) |
| | | ----- |
| | | \$7,061,457 |
| | | ===== |

</TABLE>

General and administrative expenses of \$637,993 were capitalized during the six months ended December 31, 1997.

6. LONG TERM DEBT

<TABLE>
<CAPTION>

| | | DECEMBER 31, 1997 |
|--------------|--|----------------------|
| <S> | | ----- |
| <C> | | <C> |
| Advance..... | | \$220,500 |
| Loan..... | | 675,000 |
| | | ----- |
| | | \$895,500 |
| | | ===== |

</TABLE>

The advance from non-controlling interest to NOC bears no interest unless it is not repaid by June 30, 2000, at which time it would bear interest at 15% until repayment. The loan from non-controlling interest to NOC bears interest at a rate of 10% and is repayable out of surplus funds of NOC as and when available.

7. SHARE CAPITAL AND SPECIAL WARRANTS

AUTHORIZED

Unlimited number of voting common shares
 Unlimited number of first preferred shares
 Unlimited number of second preferred shares

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED
 (STATED IN U.S. DOLLARS)

7. SHARE CAPITAL AND SPECIAL WARRANTS -- (CONTINUED)

<TABLE>

<CAPTION>

ISSUED COMMON SHARES

| | NUMBER | AMOUNT |
|---|------------|-------------|
| - - - - - | - - - - - | - - - - - |
| <S> | <C> | <C> |
| Balance on incorporation, opening balance..... | 1,000 | \$ 100 |
| Issued upon contribution of an interest in NOC [note 3]..... | 8,275,250 | 3,187,000 |
| Issued to CanArgo Ltd. [note 4]..... | 1,708,641 | 31,975 |
| Issued for cash..... | 453,500 | 698,390 |
| | - - - - - | - - - - - |
| Balance, December 31, 1997..... | 10,438,391 | \$3,917,465 |
| | - - - - - | - - - - - |
| SPECIAL WARRANTS | | |
| Special warrants issued..... | 1,636,597 | \$2,520,359 |
| Issue costs..... | -- | (498,082) |
| | - - - - - | - - - - - |
| Balance, December 31, 1997..... | 1,636,597 | \$2,022,277 |
| | - - - - - | - - - - - |
| WARRANTS ISSUED AND BALANCE, DECEMBER 31, 1997..... | 681,760 | \$ -- |
| | - - - - - | - - - - - |
| TOTAL SHARE CAPITAL AND SPECIAL WARRANT, DECEMBER 31, 1997..... | | \$5,939,742 |
| | | ===== |

</TABLE>

On June 30, 1997, the shareholders approved a 40 for 1 consolidation of all the outstanding common shares. The record date of the stock consolidation was July 2, 1997. Accordingly, all references to number of shares and per share information prior to July 2, 1997 have been adjusted to reflect the share consolidation retroactively.

On November 3, 1997, the Corporation closed a private placement of 1,636,597 special warrants at a price of Canadian \$2.20 per special warrant. Each special warrant is convertible into one common share of the Corporation and one half of one warrant. Each full warrant is exercisable into one common share at a price of Canadian \$2.60 per share through to November 1, 1999.

In conjunction with the special warrant placement, 681,760 warrants were issued. Each warrant is exercisable into one common share with 455,010 being exercisable at a price of Canadian \$2.20, 250,000 warrants of which expire on June 30, 1998 and 205,010 warrants of which expire April 30, 1999, and 226,750 being exercisable at a price of Canadian \$2.60 and expiring on November 1, 1999.

If the Corporation has not obtained a receipt for a final prospectus indicating the qualification of these securities in each relevant jurisdiction by February 28, 1998 then each special warrant will entitle the holder to receive an additional 0.1 common share and 0.05 warrant without payment of additional

consideration.

INCENTIVE STOCK OPTION PLAN

During the period ended December 31, 1997, 1,035,000 common share options were granted; none were exercised. At December 31, 1997, options exercisable between 1998

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED (STATED IN U.S. DOLLARS)

7. SHARE CAPITAL AND SPECIAL WARRANTS -- (CONTINUED)

and 2002 were outstanding to purchase 1,035,000 common shares at a price of \$2.20 per share.

8. CONTINGENCIES

The non-controlling shareholder in NOC has initiated legal proceedings in Cyprus claiming that a share offer in NOC had not been accepted by the majority shareholder in the time limits set out and accordingly the share issuance to the majority shareholder was invalid. If the non-controlling shareholder is successful in its application before the Cyprus courts, the interest of the Corporation in NOC could be reduced to 49%. The Corporation has obtained a legal opinion from Cypriot counsel confirming the appropriate acceptance of the subscriptions to the share offer. Subsequent to December 31, 1997, the non-controlling shareholder withdrew its legal action without prejudice. Accordingly, the Corporation continues to maintain that the legal proceedings are without merit and consolidates its 55.9% share holding.

9. SUBSEQUENT EVENTS

On February 2, 1998, the Corporation entered into an agreement with Fountain Oil Incorporated ("Fountain") under which a business combination would be effected through an exchange of shares. Each common share of the Corporation is exchangeable into 1.6 common shares of Fountain. This business combination is subject to regulatory and shareholder approval.

10. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IN THE UNITED STATES

The Corporation's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada, which in the case of the Corporation at December 31, 1997, conforms in all material respects with United States GAAP, except as set forth below.

(a) Adjustments to consolidated loss per share

<TABLE>

<CAPTION>

| | 1997 |
|---|--------------|
| | ----- |
| <S> | <C> |
| Loss in accordance with Canadian and U.S. GAAP..... | \$ (255,827) |
| | ----- |
| Loss per share in accordance with U.S. GAAP..... | \$ (0.02) |
| | ----- |
| Weighted average number of common shares outstanding during period in accordance with U.S. GAAP..... | 10,757,176 |
| | ===== |

</TABLE>

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CANARGO OIL & GAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- CONTINUED
(STATED IN U.S. DOLLARS)

10. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IN THE UNITED STATES -- (CONTINUED)

(b) Adjustments to consolidated statements of cash flows in respect of non-cash investing and financing activities.

<TABLE>
<CAPTION>

| | 1997 |
|--|---------------|
| | ----- |
| <S> | <C> |
| INVESTING ACTIVITIES | |
| In accordance with Canadian GAAP..... | \$(5,592,949) |
| Add: | |
| Contribution of NOC assets, net of cash..... | 2,694,705 |
| Acquisition of Money Works, net of cash..... | 29,249 |
| | ----- |
| INVESTING ACTIVITIES IN ACCORDANCE WITH U.S. GAAP..... | \$(2,868,995) |
| | ===== |
| FINANCING ACTIVITIES | |
| In accordance with Canadian GAAP..... | \$ 6,810,242 |
| Less: | |
| Issue of share capital on contribution of NOC assets..... | (3,187,000) |
| Issue of share capital on contribution of Money Works..... | (31,975) |
| Add: | |
| Contribution of NOC assets, net of cash..... | 492,295 |
| Acquisition of Money Works, net of cash..... | 2,726 |
| | ----- |
| FINANCING ACTIVITIES IN ACCORDANCE WITH U.S. GAAP..... | \$ 4,086,288 |
| | ===== |

</TABLE>

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CANARGO OIL & GAS INC.

SUPPLEMENTAL DISCLOSURES ABOUT OIL AND GAS
PRODUCTION ACTIVITIES
(UNAUDITED, STATED U.S. DOLLARS)

The following information about the Corporation's oil producing activities is presented in accordance with United States Statement of Financial Accounting Standards No. 69: Disclosures About Oil and Gas Producing Activities.

OIL RESERVES

Proved oil reserves are the estimated quantities of crude oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions.

Proved developed oil reserves are reserves that can be expected to be recovered from existing wells with existing equipment and operating methods.

Estimates of oil reserves are subject to uncertainty and will change as additional information regarding the producing fields and technology becomes available and as economic conditions change.

Reserves presented in this section represent NOC's working interest share of reserves net of royalties. The Corporation has a 55.9% beneficial interest in

the reserves of NOC. Reserves at December 31, 1997 are based on estimates by the independent petroleum-engineering firm, AMH Group Ltd. and are all located in the Republic of Georgia.

The Corporation's net proved and net proved developed oil reserves were as follows:

| <TABLE> <CAPTION> NET PROVED RESERVES | | NOC |
|---|--|---------------------------|
| - - - - - | | ----- |
| <S> | | (THOUSANDS OF BARRELS) |
| | | <C> |
| Crude oil | | |
| Net proved reserves, June 30, 1997(1)..... | | 5,675 |
| Production..... | | (112) |
| Reserve additions(1)..... | | 5,452 |
| | | ----- |
| NET PROVED RESERVES, DECEMBER 31, 1997..... | | 11,015 |
| | | ===== |
| NET PROVED DEVELOPED RESERVES | | |
| June 30, 1997(1)..... | | 994 |
| December 31, 1997..... | | 1,929 |
| </TABLE> | | |

(1) Estimated by management as the first reserve report prepared for the Corporation was as of December 31, 1997.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS AND CHANGES THEREIN RELATING TO PROVED OIL RESERVES

The following standardized measure of discounted future net cash flows from proved oil reserves has been computed using period end prices and costs and period end statutory tax

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CANARGO OIL & GAS INC.

SUPPLEMENTAL DISCLOSURES ABOUT OIL AND GAS -- CONTINUED PRODUCTION ACTIVITIES (UNAUDITED, STATED U.S. DOLLARS)

rates. A discount rate of 10% has been applied in determining the standardized measure of discounted future net cash flows.

This information does not necessarily reflect the fair market value of its oil properties. Actual future net cash flows will differ from the presented estimated future net cash flows in that:

- (i) future production from proved reserves will differ from estimated production;
- (ii) future production will also include production from probable and potential reserves;
- (iii) future rather than year end prices and costs will apply; and
- (iv) existing economic, operating and regulatory conditions are subject to change.

The standardized measure of discounted future net cash flows is as follows:

<TABLE>
<CAPTION>

| | NOC |
|---|----------------|
| | ----- |
| | (IN THOUSANDS) |
| | <C> |
| <S> | |
| DECEMBER 31, 1997 | |
| Future cash inflows..... | \$113,567 |
| Future production, development and restoration costs..... | 73,664 |
| | ----- |
| Future net cash flows..... | \$ 39,903 |
| Ten percent annual discount..... | 14,255 |
| | ----- |
| Standardized measure..... | \$ 25,648 |
| | ===== |

</TABLE>

The changes in the standardized measure of discounted future net cash flows for the period is as follows:

<TABLE>
<CAPTION>

| | NOC |
|--|----------------|
| | ----- |
| | (IN THOUSANDS) |
| | <C> |
| <S> | |
| JULY 1, 1997(1)..... | \$12,951 |
| Oil sales net of production costs..... | (534) |
| Oil discoveries(1)..... | 16,100 |
| Development costs incurred..... | 2,869 |
| | ----- |
| DECEMBER 31, 1997..... | \$25,648 |
| | ===== |

</TABLE>

- - - - -

(1) Estimated by management as the first reserve report prepared for the Corporation was as of December 31, 1997.

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CANARGO OIL & GAS INC.

SUPPLEMENTAL DISCLOSURES ABOUT OIL AND GAS -- CONTINUED
PRODUCTION ACTIVITIES
(UNAUDITED, STATED U.S. DOLLARS)

Costs incurred in oil property acquisition, exploration and development activities:

<TABLE>
<CAPTION>

| | NOC |
|------------------------------------|----------------|
| | ----- |
| | (IN THOUSANDS) |
| | <C> |
| <S> | |
| SIX MONTHS ENDED DECEMBER 31, 1997 | |
| Property acquisition | |
| Proved..... | -- |
| Unproved..... | -- |
| Development..... | \$2,869 |
| Exploration..... | -- |
| | ----- |

\$2,869

=====

</TABLE>

Depletion per unit of net production:

<TABLE>

<CAPTION>

NOC

(\$ PER BOE)

<S>

Six months ended December 31, 1997.....

<C>
\$4.98

</TABLE>

Results of operations for oil producing activities:

<TABLE>

<CAPTION>

NOC

(IN THOUSANDS)
<C>

<S>

SIX MONTHS ENDED DECEMBER 31, 1997

Sales.....

\$1,324

Royalty and production expense.....

(790)

Depletion.....

(556)

Loss before tax.....

\$ (22)

Income tax.....

--

RESULTS OF OPERATIONS FROM PRODUCING ACTIVITIES.....

\$ (22)

=====

</TABLE>

NOC's share of revenues under the PSC is determined by the price of Brent crude oil, less transportation charges. At current world oil prices, NOC's share of revenues under the PSC is insufficient to cover royalty, production and depletion expenses. In order to cover royalty, production and depletion expenses under the PSC, at current production volumes of approximately 1,900 barrels per day, the price for Brent crude will need to be approximately US\$16.50 per barrel. The closing price for Brent crude on May 25, 1998 was US\$14.26 per barrel.

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FINANCIAL STATEMENTS

NINOTSMINDA OIL COMPANY LIMITED
(FORMERLY JKK (NINOTSMINDA) LIMITED)

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AUDITORS' REPORT

To the Directors of
Ninotsminda Oil Company Limited
(formerly "JKK (Ninotsminda) Limited")

We have audited the financial statements of Ninotsminda Oil Company Limited and have obtained all the information and explanations we considered necessary. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based

on our audit.

We conducted our audit in accordance with International Standards on Auditing. These standards are substantially in accordance with United States generally accepted auditing standards. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, proper books of account have been kept by the Company and the financial statements, which are in agreement therewith give a true and fair view of the state of affairs of Ninotsminda Oil Company Limited for the six months ended June 30, 1997 and the year ended December 31, 1996 and of its profit and cash flows for the periods then ended in accordance with International Accounting Standards and comply with the provisions of the Companies Law, Chapter 113.

<TABLE>

<S>

Limassol, Cyprus
February 18, 1998

</TABLE>

<C>

/s/ Ernst & Young
Ernst & Young
Chartered Accountants

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NINOTSMINDA OIL COMPANY LIMITED

BALANCE SHEET

(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

| | JUNE 30, 1997 | DECEMBER 31, 1996 |
|--------------------------------------|------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| ASSETS | | |
| CURRENT | | |
| Cash..... | \$ 492,300 | \$1,565,800 |
| Accounts receivable..... | 716,300 | 373,500 |
| Inventory..... | 82,600 | 49,600 |
| | ----- | ----- |
| | 1,291,200 | \$1,988,900 |
| Oil and gas properties [note 6]..... | 4,081,700 | 2,069,900 |
| | ----- | ----- |
| | \$5,372,900 | \$4,058,800 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT | | |
| Accounts payable..... | \$ 67,500 | \$ 25,600 |
| Taxes payable..... | 61,000 | 61,000 |
| Due to shareholders [note 7]..... | 783,800 | 188,800 |
| | ----- | ----- |
| | 912,300 | 275,400 |
| Long term debt [note 8]..... | 1,350,000 | 2,411,600 |
| | ----- | ----- |
| | 2,262,300 | 2,687,000 |
| | ----- | ----- |

SHAREHOLDERS' EQUITY

| | | |
|-----------------------------|-------------|-------------|
| Retained earnings..... | 1,291,300 | 1,367,500 |
| Share premium [note 9]..... | 1,814,300 | -- |
| Share capital [note 9]..... | 5,000 | 4,300 |
| | ----- | ----- |
| | 3,110,600 | 1,371,800 |
| | ----- | ----- |
| | \$5,372,900 | \$4,058,800 |
| | ===== | ===== |

</TABLE>

See accompanying notes

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NINOTSMINDA OIL COMPANY LIMITED

STATEMENT OF OPERATIONS AND RETAINED EARNINGS

(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

| | SIX MONTHS ENDED JUNE 30, 1997 | PERIOD OCTOBER 24, 1995 TO DECEMBER 31, 1996 |
|---|---|--|
| | ----- | ----- |
| <S> | <C> | <C> |
| REVENUE | | |
| Oil..... | \$1,500,000 | \$3,058,900 |
| Other..... | 17,400 | 16,000 |
| | ----- | ----- |
| | 1,517,400 | 3,074,900 |
| | ----- | ----- |
| EXPENSES | | |
| Operating..... | 638,200 | 962,500 |
| General and administrative [note 10]..... | 216,400 | 415,900 |
| Interest [note 4]..... | 76,000 | 188,900 |
| Depletion..... | 663,000 | 79,100 |
| | ----- | ----- |
| | 1,593,600 | 1,646,400 |
| | ----- | ----- |
| (LOSS) INCOME BEFORE TAXES..... | (76,200) | 1,428,500 |
| Provision for income taxes..... | -- | 61,000 |
| | ----- | ----- |
| (LOSS) NET INCOME FOR THE PERIOD..... | (76,200) | 1,367,500 |
| Retained earnings, beginning of period..... | 1,367,500 | -- |
| | ----- | ----- |
| RETAINED EARNINGS, END OF PERIOD..... | \$1,291,300 | \$1,367,500 |
| | ===== | ===== |

</TABLE>

See accompanying notes

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NINOTSMINDA OIL COMPANY LIMITED

STATEMENT OF CASH FLOWS

(STATED IN U.S. DOLLARS)

<TABLE>

<CAPTION>

| | SIX MONTHS ENDED JUNE 30, 1997 ----- | PERIOD OCTOBER 24, 1995 TO DECEMBER 31, 1996 ----- |
|---|---|---|
| <S> | <C> | <C> |
| OPERATING ACTIVITIES | | |
| (Loss) income before taxes..... | \$ (76,200) | \$ 1,428,500 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depletion..... | 663,000 | 79,100 |
| | ----- | ----- |
| Funds from operations..... | 586,800 | 1,507,600 |
| Changes in non-cash working capital relating to operations..... | 261,100 | (208,700) |
| | ----- | ----- |
| NET CASH PROVIDED BY OPERATING ACTIVITIES..... | 847,900 | 1,298,900 |
| | ----- | ----- |
| INVESTING ACTIVITIES | | |
| Capital asset additions..... | (2,674,800) | (2,149,000) |
| | ----- | ----- |
| NET CASH USED IN INVESTING ACTIVITIES..... | \$(2,674,800) | \$(2,149,000) |
| | ----- | ----- |
| FINANCING ACTIVITIES | | |
| Issuance of shares..... | 700 | 4,300 |
| Share premium..... | 1,814,300 | -- |
| Increase in due to shareholders..... | -- | 2,500,000 |
| Repayment of due to shareholders..... | (1,061,600) | (88,400) |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES..... | 753,400 | 2,415,900 |
| | ----- | ----- |
| Net (decrease) increase in cash..... | (1,073,500) | 1,565,800 |
| Cash, beginning of period..... | 1,565,800 | -- |
| | ----- | ----- |
| CASH, END OF PERIOD..... | \$ 492,300 | \$ 1,565,800 |
| | ===== | ===== |

</TABLE>

See accompanying notes

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NINOTSMINDA OIL COMPANY LIMITED

NOTES TO FINANCIAL STATEMENTS

(STATED IN U.S. DOLLARS)

1. INCORPORATION

The Company was incorporated in Cyprus on October 24, 1995 with minimal share capital and changed its name to Ninotsminda Oil Company Limited ("NOC") effective January 16, 1998.

2. DESCRIPTION OF BUSINESS

The primary purpose of the Company is the exploration for and production of hydrocarbons in the Republic of Georgia.

NOC operates under the terms of a Production Sharing Contract ("PSC") signed February 15, 1996 between NOC and the Republic of Georgia represented by the state oil company, Georgian Oil. Under the terms of the PSC, NOC is responsible for the costs associated with the project, which is operated on behalf of NOC by the local operating company, Georgian British Oil Company ("Georgian Oil"). Georgian Oil is responsible for the costs associated with site restoration and

abandonment, royalties and all state taxes. The PSC expires in December 2019 and provides for a five year extension. While areas of the license containing field developments are not subject to relinquishment, other areas are subject to relinquishment after 5, 10, 15 and 20 years after the date of issue of the license. Currently the Ninotsminda field is the only producing field in this license.

Production from the Ninotsminda field commenced in the early part of 1996, and during 1996 approximately 515,000 barrels of oil were produced. Under the terms of the PSC, Georgian Oil currently takes the first 750 barrels per day ("determined production") of production, after which all production is shared. The level of determined production will change in accordance with the terms of the agreement. After determined production, NOC receives up to 50% of production for cost recovery. Remaining production after cost recovery is then allocated as to 30% to NOC and as to 70% to Georgian Oil.

To date, NOC has sold all of its production to one international buyer at prices related to the world market price for Brent crude, with payment in US dollars into NOC's bank account in Cyprus.

NOC is in an early stage of operations and is effectively dealing with challenges typical of doing business in the former Soviet Union. NOC is currently not in a position to finance all its working capital and capital investment requirements through its own operations and therefore will require additional external financing.

3. ACCOUNTING POLICIES

The Company follows international accounting standards. The significant accounting policies are noted below.

ACCOUNTING CONVENTION

The financial statements are drawn up under the historical cost convention.

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NINOTSMINDA OIL COMPANY LIMITED

NOTES TO FINANCIAL STATEMENTS -- (CONTINUED)

(STATED IN U.S. DOLLARS)

3. ACCOUNTING POLICIES -- (CONTINUED)

EXCHANGE RATES

The financial statements are presented in United States dollars. The Company's revenues and exploration and production costs are denominated in U.S. dollars.

Transactions in other currencies are translated to United States dollars at the rates in effect on the transaction date. Balances are translated to United States dollars at the exchange rate in effect at the balance sheet date. Any resulting exchange gains or losses are recognized as income or expense in the year they are incurred.

OIL AND GAS PROPERTIES

The Company accounts for oil and gas expenditures under the full cost method of accounting, whereby all costs associated with the exploration for and development of crude oil and natural gas reserves are capitalized as capital assets within one global amortized cost pool.

Costs related to evaluated properties, including an estimate for future costs to develop proved reserves, are amortized through depletion charges using the unit of production method based on commercial proved crude oil reserves.

INVENTORY

Inventory is comprised of crude oil and is carried at the lower of cost and net realizable value.

4. INTEREST PAYABLE

The following amounts are included in the due to shareholder:

<TABLE>

<CAPTION>

| | JUNE 30, 1997 | DECEMBER 31, 1996 |
|-------------------------|------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| CanArgo Energy Inc..... | \$134,500 | \$ 97,800 |
| JKX Nederland BV..... | 125,400 | 91,100 |
| | ----- | ----- |
| | \$259,900 | \$188,900 |
| | ===== | ===== |

</TABLE>

5. PROFITS TAX

The Company is subject to Cyprus corporation tax on its taxable profits at the rate of 4.25%.

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NINOTSMINDA OIL COMPANY LIMITED

NOTES TO FINANCIAL STATEMENTS -- (CONTINUED)

(STATED IN U.S. DOLLARS)

6. OIL AND GAS PROPERTIES

<TABLE>

<CAPTION>

| | JUNE 30, 1997 | DECEMBER 31, 1996 |
|----------------------------------|------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Cost | | |
| Opening balance..... | \$2,149,000 | \$ -- |
| Additions during the period..... | 2,674,800 | 2,149,000 |
| | ----- | ----- |
| At December 31..... | 4,823,800 | 2,149,000 |
| | ----- | ----- |
| Depletion | | |
| Opening balance..... | 79,100 | -- |
| Charge for the period..... | 663,000 | 79,100 |
| | ----- | ----- |
| At December 31..... | 742,100 | 79,100 |
| | ----- | ----- |
| Net book value | | |
| At December 31..... | \$4,081,700 | \$2,069,900 |
| | ===== | ===== |

</TABLE>

7. DUE TO SHAREHOLDERS

Amounts falling due within one year:

<TABLE>
<CAPTION>

| | JUNE 30, 1997 | DECEMBER 31, 1996 |
|-------------------------|------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| CanArgo Energy Inc..... | \$134,500 | \$ 97,800 |
| JKX Nederland BV..... | 649,300 | 91,100 |
| | ----- | ----- |
| | \$783,800 | \$188,900 |
| | ===== | ===== |

</TABLE>

8. LONG TERM DEBT

<TABLE>
<CAPTION>

| | JUNE 30, 1997 | DECEMBER 31, 1996 |
|-------------------------|------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Shareholder loans | | |
| CanArgo Energy Inc..... | \$ 675,000 | \$1,500,000 |
| JKX Nederland BV..... | 675,000 | 911,600 |
| | ----- | ----- |
| | \$1,350,000 | \$2,411,600 |
| | ===== | ===== |

</TABLE>

The shareholder loans bear interest at the rate of 10% per annum and are repayable out of surplus funds as and when available.

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NINOTSMINDA OIL COMPANY LIMITED

NOTES TO FINANCIAL STATEMENTS -- (CONTINUED)

(STATED IN U.S. DOLLARS)

9. SHARE CAPITAL

AUTHORIZED

10,000 shares at a par value of L1 each

ISSUED

<TABLE>
<CAPTION>

| | NUMBER | VALUE |
|---------------------------------|--------|---------|
| | ----- | ----- |
| <S> | <C> | <C> |
| Issued during 1996..... | 2,000 | \$4,300 |
| | ----- | ----- |
| Balance, December 31, 1996..... | 2,000 | \$4,300 |
| Issued for cash..... | 363 | 700 |
| | ----- | ----- |
| Balance, June 30, 1997..... | 2,363 | \$5,000 |
| | ===== | ===== |

</TABLE>

During 1997, the Company issued 203 shares to CanArgo and 160 shares to JKX Nederland B.V. at a price of \$5,000 per share. The amount paid in excess of the nominal value of the shares is recorded as share premium.

10. RELATED PARTY TRANSACTIONS

During 1997, members of the JKC Oil & Gas plc ("JKC") group of companies, including JKC Nederland B.V. (44.1% shareholder in NOC at December 31, 1997) performed services and procured goods and services on behalf of NOC. These goods and services recharged by JKC to NOC, excluding interest expense, totaled \$531,300 for the six month period ended June 30, 1997 (December 31, 1996 -- \$743,000) of which \$381,900 has not yet been agreed to by NOC.

11. SHAREHOLDER DISPUTES

There are disputes between shareholders as to their relative ownership interests in NOC. The resolution of these disputes may result in a reallocation of amounts between contributed surplus and due to shareholders.

12. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IN THE UNITED STATES

The Company's financial statements have been prepared in accordance with international generally accepted accounting principles, which in the case of the Company conform in all material respects with United States GAAP.

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PRO FORMA FINANCIAL INFORMATION

Effective March 4, 1997 various stockholders, who together owned 55.9% of Ninotsminda Oil Company Limited ("NOC") contributed their common stock in NOC for common stock of CanArgo Ltd., a newly formed corporation formed for the purpose of holding the NOC interests. There was no change in the individual stockholders' effective ownership of NOC as a result of the formation of CanArgo Ltd. Effective July 1, 1997, the shareholders of CanArgo Ltd. exchanged their shares for a controlling interest in Money Works Inc., a company incorporated under the Alberta Business Corporation Act. Money Works Inc. had no substantive operations at July 1, 1997. The exchange was accounted for as a reorganization (a reverse takeover under Canadian GAAP) and not a business combination. After the exchange with Money Works, Inc., the stockholder group that formed CanArgo Ltd. owned 82% of the outstanding common stock of Money Works Inc., and Money Works, Inc. changed its name to CanArgo Energy Inc. The formation of CanArgo Ltd. and the Money Works, Inc. reorganization are collectively referred to as the "reorganization" in the accompanying unaudited condensed combined pro forma financial statements and notes and supplemental disclosures thereto.

The following unaudited pro forma condensed combined statements of operations for the nine months ended September 30, 1998 give effect to the July 1998 business combination between the Company and CanArgo Energy Inc., now the Company's subsidiary CanArgo Oil & Gas Inc. (the "Transaction") as if it had occurred on January 1, 1997. In addition, the unaudited pro forma condensed combined statement of operations for the year ended December 31, 1997 reflects the effect of the reorganization on the Company's statements of operations as if it had occurred on January 1, 1997. The unaudited pro forma condensed combined financial statements have been derived from and should be read in connection with the financial statements included elsewhere in this Prospectus.

The unaudited pro forma condensed combined financial statements do not purport to represent (i) what the Company's financial position or results of operations would have been had the Transaction occurred on the dates indicated or to project the Company's financial position or results of operations for any future period or (ii) what the Company's results of operations would have been had the reorganization occurred on the date indicated or to project the Company's results of operations for any future period. Furthermore, the unaudited pro forma condensed combined financial statements do not reflect changes which may occur as the result of activities after the consummation of the Transaction and the reorganization.

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UNAUDITED PRO FORMA CONDENSED
COMBINED STATEMENT OF OPERATIONS

NINE MONTHS ENDED SEPTEMBER 30, 1998

<TABLE>
<CAPTION>

| | HISTORICAL | | | |
|--|---------------|----------------------|-------------|---------------|
| | COMPANY | CANARGO OIL & GAS | ADJUSTMENTS | PRO FORMA |
| <S> | <C> | <C> | <C> | <C> |
| REVENUES..... | \$ 519,990 | \$ 992,952 | \$ -- | \$ 1,512,942 |
| Operating expenses | | | | |
| Lease operating expenses..... | 477,263 | 771,652 | -- | 1,248,915 |
| Direct project costs..... | 1,023,336 | -- | -- | 1,023,336 |
| General and administrative..... | 2,720,932 | 703,652 | -- | 3,424,584 |
| Depreciation and amortization..... | 261,420 | 527,676 | 100,000(2) | 889,096 |
| Loss from investment in unconsolidated subsidiaries..... | 152,225 | -- | -- | 152,225 |
| Writedown of oil and gas properties..... | 900,000 | -- | -- | 900,000 |
| Total operating expenses..... | 5,535,176 | 2,002,980 | 100,000 | 7,638,156 |
| OPERATING LOSS..... | (5,015,186) | (1,010,028) | (100,000) | (6,125,214) |
| Other income (expense), net..... | 171,279 | 7,959 | -- | 179,238 |
| Net loss before income tax..... | (4,843,907) | (1,002,069) | (100,000) | (5,945,976) |
| Income tax expense..... | -- | -- | -- | -- |
| Net loss before minority interest.... | (4,843,907) | (1,002,069) | (100,000) | (5,945,976) |
| Minority interest in loss of subsidiary..... | 53,426 | 267,422 | -- | 320,848 |
| Net loss..... | \$(4,790,481) | \$ (734,647) | \$(100,000) | \$(5,625,128) |
| Net loss per common share | | | | |
| -- basic..... | \$ (0.34) | | | \$ (0.26)(3) |
| Net loss per common share | | | | |
| -- diluted..... | \$ (0.34) | | | \$ (0.26)(3) |
| Weighted average number of common shares outstanding..... | 14,072,572 | | | 21,194,663 |

</TABLE>

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UNAUDITED PRO FORMA CONDENSED
COMBINED STATEMENT OF OPERATIONS

YEAR ENDED DECEMBER 31, 1997

<TABLE>
<CAPTION>

HISTORICAL

| | ADJUSTMENTS | | | | |
|---|----------------|----------------------|----------------|-------------|----------------|
| | COMPANY | CANARGO OIL & GAS | REORGANIZATION | TRANSACTION | PRO FORMA |
| <S> | <C> | <C> | <C> | <C> | <C> |
| REVENUES..... | \$ 313,301 | \$1,324,114 | \$1,500,000(1) | \$ -- | \$ 3,137,415 |
| Operating expenses | | | | | |
| Lease operating expenses..... | 200,321 | 790,287 | 638,200(1) | -- | 1,628,808 |
| Direct project costs..... | 1,753,166 | -- | -- | -- | 1,753,166 |
| General and administrative..... | 3,903,446 | 386,397 | 216,400(1) | -- | 4,506,243 |
| Depreciation and amortization..... | 344,666 | 555,960 | 663,000(1) | 89,000(2) | 1,652,626 |
| Loss from investment in unconsolidated subsidiaries..... | 3,778,287 | -- | -- | -- | 3,778,287 |
| Impairment of oil and gas ventures..... | 15,735,592 | -- | -- | -- | 15,735,592 |
| Impairment of property and equipment..... | 3,243,997 | -- | -- | -- | 3,243,997 |
| Impairment of other assets..... | 444,018 | -- | -- | -- | 444,018 |
| Total operating expenses... | 29,403,493 | 1,732,644 | 1,517,600 | 89,000 | 32,742,737 |
| OPERATING LOSS..... | (29,090,192) | (408,530) | (17,600) | (89,000) | (29,605,322) |
| Other income (expense), net..... | 1,201,861 | (11,729) | (58,600)(1) | -- | 1,131,532 |
| Net loss before income tax..... | (27,888,331) | (420,259) | (76,200) | (89,000) | (28,473,790) |
| Income tax expense..... | -- | -- | -- | -- | -- |
| Net loss before minority interest..... | (27,888,331) | (420,259) | (76,200) | (89,000) | (28,473,790) |
| Minority interest in loss of subsidiary..... | 205,380 | 164,432 | 32,842(1) | -- | 402,654 |
| Net loss..... | \$(27,682,951) | \$ (255,827) | \$ (43,358) | \$(89,000) | \$(28,071,136) |
| Net loss per common share -- basic..... | \$ (2.47) | | | | \$ (1.33) |
| (3) | | | | | |
| Net loss per common share -- diluted..... | \$ (2.47) | | | | \$ (1.33) |
| (3) | | | | | |
| Weighted average number of common shares outstanding..... | 11,206,507 | | | | |
| 21,177,425(5) | | | | | |

</TABLE>

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NOTES TO UNAUDITED PRO FORMA CONDENSED
COMBINED STATEMENTS OF OPERATIONS

1. To adjust the historical financial statements of CanArgo Oil & Gas Inc. to

reflect the operations of NOC for the period from January 1, 1997 to June 30, 1997, the date the reorganization was completed, as if the reorganization occurred on January 1, 1997.

2. To reflect additional estimated depreciation, depletion and amortization of oil and gas properties as a result of the allocation of the purchase price thereto as if the purchase of such oil and gas properties had occurred on January 1, 1997. The additional depreciation, depletion and amortization amounts were calculated on the units-of-production method based on capitalized costs as adjusted for the purchase of CanArgo Oil & Gas Inc. and estimates of pro forma proved developed and undeveloped reserves. For the nine months ended September 30, 1998, the actual depreciation, depletion and amortization rate for the Company and CanArgo Oil & Gas Inc. was \$13.94 and \$5.33 per barrel produced, respectively. For the year ended December 31, 1997, the actual depreciation, depletion and amortization rate for the Company and CanArgo Oil & Gas Inc. was \$13.15 and \$4.06 per barrel produced, respectively. The pro forma depreciation, depletion and amortization rate was approximately \$6.93 and \$9.92 per barrel produced for the nine months ended September 30, 1998 and the year ended December 31, 1997, respectively.
3. To reflect pro forma basic and diluted loss per share. Pro forma earnings per share do not reflect 2,253,512 shares of Company Common Stock issuable after the consummation of the Transaction upon exercise of options to purchase shares of CanArgo Oil & Gas Inc. Common Stock pursuant to outstanding CanArgo Oil & Gas Inc. options and upon the exchange of Exchangeable Shares issuable upon the exercise of warrants because they are antidilutive.
4. The unaudited pro forma condensed combined financial statements do not give effect to the issuance of the one hundred (100) shares (the "Preferred Shares") of Special Voting Stock. The Preferred Shares embody the right to (i) the voting power of the holders of unexchanged Exchangeable Shares following the exchange thereof for shares of Company Common Stock and (ii) the right to receive an aggregate of One Hundred Dollars (\$100) upon redemption at the rate of \$1.00 per Preferred Share following the exchange of all outstanding Exchangeable Shares.

The Preferred Shares will be stripped of their voting power proportionately as Exchangeable Shares are exchanged for shares of Company Common Stock. When fully divested of voting rights through the exchange of all Exchangeable Shares, the Preferred Shares can be redeemed for nominal consideration. Thus, the Preferred Shares do not have substance for accounting purposes.

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SUPPLEMENTARY UNAUDITED PRO FORMA COMBINED OIL AND GAS DISCLOSURES

The following supplementary unaudited pro forma combined oil reserve quantity information and standardized measure of discounted future cash flows and changes therein gives effect to the Transaction and the reorganization as if each had occurred on January 1, 1997. The supplemental unaudited pro forma combined oil information was derived from and should be read in connection with the separate supplementary disclosures of oil information of the Company included elsewhere in this Prospectus.

Users of this information should be aware that the process of estimating quantities of proved and proved developed crude oil reserves is very complex, requiring significant subjective decisions in the evaluation of all available geological, engineering and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving

production history and continual reassessment of the viability of production under varying economic conditions. Consequently, material revisions to existing reserve estimates occur from time to time. Although every reasonable effort is made to ensure that reserve estimates reported represent the most accurate assessments possible, the significance of the subjective decisions required and variances in available data for various reservoirs make these estimates generally less precise than other estimates presented in connection with financial statement disclosures.

Proved reserves are estimated quantities of natural gas, crude oil and condensate that geological and engineering data demonstrate, with reasonable certainty, to be recoverable in future years from known reservoirs with existing equipment and under existing economic and operating conditions.

Proved developed reserves are proved reserves that can be expected to be recovered through existing wells with existing equipment and under existing economic and operating conditions.

Proved undeveloped reserves are reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

No major discovery or other favorable or adverse event subsequent to December 31, 1997 is believed to have caused a material change in the estimates of proved or proved developed reserves as of that date.

The supplementary unaudited pro forma combined oil and gas information does not purport to represent what such information would have been had the Transaction and the reorganization actually occurred on January 1, 1997.

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SUPPLEMENTARY PRO FORMA COMBINED RESERVE QUANTITY INFORMATION

DECEMBER 31, 1997

<TABLE>
<CAPTION>

| | CANADA | REPUBLIC OF GEORGIA | TOTAL PRO FORMA |
|--|--------|------------------------|--------------------|
| | ----- | ----- | ----- |
| | | (OIL IN MBLS) | |
| <S> | <C> | <C> | <C> |
| Proved developed and undeveloped reserves: | | | |
| Beginning of year..... | -- | -- | -- |
| Revision of estimates..... | (33) | -- | (33) |
| Improved recovery..... | -- | -- | -- |
| Purchase of minerals in place..... | 116 | 5,675 | 5,791 |
| Extensions and discoveries..... | 267 | 5,452 | 5,719 |
| Production..... | (16) | (112) | (128) |
| | --- | ----- | ----- |
| End of year..... | 334 | 11,015(1) | 11,349 |
| | --- | ----- | ----- |
| Proved developed reserves | | | |
| Beginning of year..... | -- | -- | -- |
| End of year..... | 155 | 1,929(1) | 2,084 |
| | === | ===== | ===== |

</TABLE>

- - - - -

(1) 44.1% of these reserves are attributable to the minority interest in NOC.

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SUPPLEMENTARY PRO FORMA COMBINED STANDARDIZED MEASURE
OF DISCOUNTED FUTURE CASH FLOWS AND CHANGES THEREIN
RELATED TO PROVED OIL AND GAS RESERVES

<TABLE>
<CAPTION>

| | CANADA | REPUBLIC OF GEORGIA | PRO FORMA TOTAL |
|--|----------------------|------------------------|--------------------|
| | ----- | ----- | ----- |
| | (IN THOUSANDS OF \$) | | |
| <S> | <C> | <C> | <C> |
| Future cash..... | \$5,469 | \$113,567 | \$119,036 |
| Future production and development costs..... | 2,930 | 73,664 | 76,594 |
| Future income tax expenses(1)..... | -- | -- | -- |
| | ----- | ----- | ----- |
| Future net cash flows..... | 2,539 | 39,903 | 42,442 |
| 10% annual discount for estimated timing of cash flows..... | 1,296 | 14,255 | 15,551 |
| | ----- | ----- | ----- |
| Standardized measure of discounted future net cash flows..... | \$1,243 | \$ 25,648 | \$ 26,891 |
| | ===== | ===== | ===== |

</TABLE>

(1) No future income tax expense was provided as such taxes will be offset with net operating loss carryforwards on a historical and pro forma basis.

The following are the principal sources of change in the pro forma standardized measure of discounted future net cash flows for the period from January 1, 1997 to December 31, 1997:

<TABLE>
<CAPTION>

| | CANADA | REPUBLIC OF GEORGIA | PRO FORMA TOTAL |
|--|----------------------|------------------------|--------------------|
| | ----- | ----- | ----- |
| | (IN THOUSANDS OF \$) | | |
| <S> | <C> | <C> | <C> |
| January 1, 1997..... | -- | \$13,279 | \$13,279 |
| Purchase of oil in place..... | \$ 551 | -- | 551 |
| Sales of oil and gas net of production costs | | | |
| Net changes in prices and costs..... | (113) | (862) | (975) |
| Extensions and discoveries and improved recovery, net of related costs..... | 745 | 18,775 | 19,520 |
| Development costs incurred..... | -- | (5,544) | (5,544) |
| Revision of previous estimates..... | (141) | -- | (141) |
| Accretion of discount..... | 55 | -- | 55 |
| Timing and other..... | 146 | -- | 146 |
| | ----- | ----- | ----- |
| December 31, 1997..... | \$1,243 | \$25,648 | \$26,891 |
| | ===== | ===== | ===== |

</TABLE>

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PART II

INFORMATION NOT REQUIRED IN THE PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution

The following table sets forth the costs and expenses of the sale and distribution of the securities being registered, all of which are being borne by the Company.

| <TABLE> | |
|---|-------------|
| <S> | |
| | <C> |
| Securities and Exchange Commission filing fee | \$ 1,663.00 |
| Printing expenses | * |
| Legal fees and expenses | * |
| Accounting fees and expenses | * |
| Miscellaneous | * |
| | ----- |
| Total | \$ * |
| </TABLE> | |

* To be filed by amendment.

All of the amounts shown are estimates except for the fees paid to the Securities and Exchange Commission.

Item 14. Indemnification of Directors and Officers

The Delaware General Corporation Law ("DGCL") provides that a corporation may indemnify its present and former directors, officers, employees and agents (each, an "indemnitee") against all reasonable expenses (including attorneys' fees) and, except in actions initiated by or in the right of the corporation, against all judgments, fines and amounts paid in settlement in actions brought against them, if such individual acted in good faith and in a manner which he or she reasonably believed to be in, or not opposed to, the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. A corporation must indemnify an indemnitee to the extent that he or she is successful on the merits or otherwise in the defense of any claim, issue or matter associated with an action, suit or proceeding, including one initiated by or in the right of the corporation. The Company's Bylaws provide for indemnification of directors and officers to the fullest extent permitted by the DGCL.

The DGCL permits, and the Company's Bylaws require, the advance payment of an indemnity for expenses prior to the final disposition of an action, provided that the indemnitee undertakes to repay any such amount advanced if it is later determined that the indemnitee is not entitled to indemnification with regard to the action for which the expenses were advanced. The Company has directors' and officers' liability insurance covering losses arising from claims based on breaches of duty, negligence, error and other wrongful acts.

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Item 15. Recent Sales of Unregistered Securities

All amounts have been restated to give effect to 1-for-2 reverse stock split on July 15, 1998. Except as stated in paragraphs 3 and 5 below, no underwriters were used in the offerings.

Whenever reference is made to securities sold in reliance on Regulation S, the registrant obtained (i) representations from the purchaser of the securities that (A) the purchaser was not a U.S. person; (B) the purchaser acquired the securities for his own account and not for the account or benefit of any other person, including without limitation any U.S. person; and (C) the purchaser was outside the United States at the time the securities were purchased; and (ii) the agreement of the purchaser that the securities would not be transferred in the United States or to any U.S. person or to any person who would hold the securities for the account or benefit of a U.S. person unless the securities were registered under the Securities Act of 1933, as amended (the "Act") or an exemption from such registration were available. The certificates representing

the securities were delivered outside the United States.

(1) The registrant issued shares upon the exercise of stock options originally issued in August 1994 at various dates set forth below. The options expire August 16, 1999 and are exercisable at \$3.00 per share. The shares were sold in reliance on Regulation S. Total proceeds to registrant: \$252,000.

<TABLE>

<CAPTION>

| Date exercised ----- | No. of Shares ----- | No. of Purchasers ----- |
|-------------------------|------------------------|----------------------------|
| <S> | <C> | <C> |
| 2/2/96 | 6,000 | 1 |
| 6/10/96 | 20,000 | 1 |
| 9/96 | 6,000 | 1 |
| 1/7/97 | 34,000 | 1 |
| 5/19/97 | 18,000 | 1 |
| | ----- | |
| | 84,000 | |

</TABLE>

(2) The registrant issued shares upon the exercise of stock purchase warrants that were originally issued in August 1994 at various dates set forth below. The warrants expired November 3, 1997 and were exercisable at \$3.00 per share. 220,661 warrants and the underlying shares were issued and sold to a total of 19 purchasers in reliance on Regulation S and 7,112 warrants and underlying shares were sold to one purchaser in reliance on Section 4(2) of the Act in the manner described in paragraph 8. Total proceeds to registrant: \$683,169.

<TABLE>

<CAPTION>

| Date exercised ----- | No. of Shares ----- | No. of Purchasers ----- |
|-------------------------|------------------------|----------------------------|
| <S> | <C> | <C> |
| 6/96 | 14,611 | 3 |
| 7/96 - 8/96 | 7,000 | 2 |
| 10/96 | 75,000 | 6 |

</TABLE>

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<TABLE>

<CAPTION>

| Date exercised ----- | No. of Shares ----- | No. of Purchasers ----- |
|-------------------------|------------------------|----------------------------|
| <S> | <C> | <C> |
| 11/96 -12/96 | 131,112 | 9 |
| | ----- | |
| | 227,723 | |

</TABLE>

(3) Between April 1, 1996 and October 16, 1996, registrant issued and sold 528,225 shares of its Common Stock, upon conversion of its 8% Convertible Subordinated Debentures. The Company issued \$3,750,000 principal amount of Debentures at par in January and February 1996. The Debentures were issued and sold to fifteen (15) offshore investors in reliance upon Regulation S. U.S. Sachem Financial Consultants, L.P. acted as the placement agent. Placement fees were 8% of gross proceeds, plus 1% of gross proceeds and \$15,000 for expenses.

(4) On May 9, 1996, registrant issued and sold 75,000 shares of its Common Stock, paid \$161,000 and assumed a \$50,000 loan in exchange for 10 shares (10%) of UK-RAN Oil Corporation and 500,000 shares (33%) of UK-RAN Energy Corporation. The 75,000 shares were valued at market price on date of issuance - \$684,375.

The shares were issued to a Canadian company in reliance on Regulation S.

(5) On June 5, 1996, registrant issued and sold an aggregate of 2,500,000 shares of its Common Stock in a private placement to a total of fifty (50) institutional and other qualified investors in Norway and other European countries in reliance upon Regulation S. The placement was made at \$9.00 per share and registrant received aggregate proceeds of \$22,500,000. Orkla Finans (Fondsmegling) AS of Norway acted as placement agent. Placement fees were 6% of gross proceeds plus out-of-pocket expenses.

(6) On June 12, 1996, registrant issued and sold 150,000 shares of its Common Stock in exchange for 25,206 shares (6%) of Intergas JSC. The 150,000 shares were valued at market price on date of issuance - \$1,668,750. The shares were issued to a British Virgin Islands company, the designee of the two Russian individuals who transferred their ownership of the 25,206 shares of Intergas JSC to the registrant. The shares were sold in reliance on Regulation S.

(7) On September 9, 1996, registrant called for redemption a series of stock purchase warrants issued in March 1995, having an original expiration date of February 28, 1997, and entitling the two holders thereof to purchase shares of registrant's Common Stock at an exercise price of \$10.20 per share. In connection therewith, registrant set October 4, 1996 as the redemption date for the warrants. On September 25 and October 2, 1996, Registrant issued and sold an aggregate of 569,900 shares of its Common Stock upon exercise of the warrants for aggregate proceeds of \$5,812,980. The shares were issued in reliance on Regulation S.

(8) On October 29, 1996, a registered holder exercised 7,143 warrants issued in July 1994, having an original expiration date of June 30, 1997, and entitling the holder thereof to purchase shares of registrant's Common Stock at an exercise price of \$3.50 per share. In connection with such exercise of warrants, registrant issued and sold an aggregate of 7,143 shares of its Common Stock, and registrant received aggregate proceeds of \$25,000.

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The offer and sale of the shares was exempt from the registration requirements of the Act under Section 4(2) of the Act as a transaction by an issuer not involving a public offering. The purchaser of the warrant shares represented to the registrant, among other things, that he was acquiring the warrant shares for his own account and that he was acquiring the shares for investment and not with a view towards the distribution thereof; and agreed that he would not sell the shares without registration under the Act or an applicable exemption from such registration requirement. The certificate representing the shares has a restrictive legend endorsed thereon reflecting the restrictions on transferability arising out of the foregoing matters, and the Company has issued "stop transfer" instructions to its transfer agent with respect to the shares.

(9) On November 29, 1996, registrant called for redemption a series of stock purchase warrants issued in February and March 1995, having an original expiration date of February 28, 1997, and entitling the 34 holders thereof to purchase shares of registrant's Common Stock at an exercise price of \$12.00 per share. Registrant set December 31, 1996 as the redemption date. Between December 13 and December 31, 1996, registrant issued and sold an aggregate of 1,540,000 shares of its Common Stock upon exercise of the warrants for aggregate proceeds of \$18,840,000. The shares were sold in reliance on Regulation S.

(10) On February 11, 1997, the registrant issued 87,500 shares of its Common Stock, pursuant to an obligation to issue the shares upon the signing of a joint venture agreement formed to acquire rights to develop and produce hydrocarbons from an oil and gas field in Western Ukraine. The Shares were issued to the assignee of an Australian corporation that transferred to registrant all of such corporation's rights to pursue a project relating to that oil and gas field, in partial consideration of the transfer. The 87,500 shares

were valued at market price on date of issuance - \$1,060,938. The shares were issued in reliance on Regulation S.

(11) On January 15, 1999, the registrant sold 250,000 shares of Common Stock in exchange for oil and gas interests in the Republic of Georgia, including contractual obligations of NOC. The shares were valued at the market price on the date of issuance: \$109,500. The shares were sold in reliance on Section 4(2) of the Act on the same basis as described in paragraph 8 above.

Item 16. Exhibits and Financial Statement Schedules

(a) The following exhibits are filed herewith or incorporated herein by reference:

(*) Management Contracts, Compensation Plans and Arrangements are identified by an asterisk

2(1) Amended and Restated Combination Agreement between Fountain Oil Incorporated and CanArgo Energy Inc. dated as of February 2, 1998 (Incorporated herein by reference from Form S-3 Registration Statement, File No. 333-48287 filed on June 9, 1998).

2(2) Voting, Support and Exchange Trust Agreement (Incorporated herein by reference as Annex G from Form S-3 Registration Statement, File No. 333-48287 filed on June 9, 1998).

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- 3(1) Registrant's Certificate of Incorporation and amendments thereto (Incorporated herein by reference from July 15, 1998 Form 8-K).
- 3(2) Registrant's Bylaws (Incorporated herein by reference from December 31, 1996 Form 10-K).
- 4(1) Form of 8% Convertible Subordinated Debenture (Incorporated herein by reference from February 29, 1996 Form 10-QSB).
- 5(1) Opinion of Kelly Lytton Mintz & Vann LLP. -- to be filed by amendment.
- *10(1) Securities Compensation Plan (Incorporated herein by reference from August 31, 1994 Form 10-KSB, filed by Electromagnetic Oil Recovery, Inc., the Company's predecessor).
- *10(2) Form of Certificate for Common Stock Purchase Warrants issued pursuant to the Securities Compensation Plan (Incorporated herein by reference from Form S-8 Registration Statement, File No. 33-82944 filed on August 17, 1994, filed by Electromagnetic Oil Recovery, Inc., the Company's predecessor).
- *10(3) Form of Option Agreement for options granted to certain persons, including Directors (Incorporated herein by reference from August 31, 1994 Form 10-KSB, filed by Electromagnetic Oil Recovery, Inc., the Company's predecessor).
- *10(4) Form of Certificate for Common Stock Purchase Warrants issued to certain investors in August 1994, including Directors (Incorporated herein by reference from August 31, 1994 Form 10-KSB, filed by Electromagnetic Oil Recovery, Inc., the Company's predecessor).
- *10(5) Restated Employment Agreement between Fountain Oil

Incorporated and Nils N. Trulsvik (Incorporated herein by reference from December 31, 1997 Form 10-K/A).

- *10(6) Employment Agreement between Fountain Oil Incorporated and Ravinder S. Sierra (Incorporated herein by reference from August 31, 1995 Form 10-KSB).
- *10(7) Amended and Restated 1995 Long-Term Incentive Plan (Incorporated herein by reference from September 30, 1998 Form 10-Q).
- *10(8) Fee Agreement dated November 15, 1995 between Fountain Oil Incorporated and Robert A. Halpin (Incorporated herein by reference from August 31, 1996 Form 10-KSB).
- *10(9) Fee Agreement between Fountain Oil Incorporated and Eugene J. Meyers (Incorporated herein by reference from August 31, 1996 Form 10-KSB).

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- *10(10) Amended Fee Agreement dated December 10, 1996 between Fountain Oil Incorporated and Robert A. Halpin (Incorporated herein by reference from December 31, 1996 Form 10-K).
- *10(11) Employment Agreement between Fountain Oil Incorporated and Alfred Kjemperud (Incorporated herein by reference from March 31, 1997 Form 10-Q).
- *10(12) Employment Agreement between Fountain Oil Norway AS and Rune Falstad (Incorporated herein by reference from December 31, 1997 Form 10-K/A).
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- *10(15) Consultancy Agreement between CanArgo Energy Corporation and Fincom AS, Norway (Incorporated herein by reference from September 30, 1998 Form 10-Q).
- *10(16) Employment Contract between CanArgo Energy Inc. and Anthony J. Potter (Incorporated herein by reference from September 30, 1998 Form 10-Q).
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- 10(18) Convertible Loan Agreement between Ninotsminda Oil Company (NOC) and International Finance Corporation (IFC) dated December 17, 1998.
- 10(19) Put Option Agreement between CanArgo Energy Corporation, JKK Oil & Gas PLC. and IFC dated December 17, 1998.
- 10(20) Guarantee Agreement between CanArgo Energy Corporation and IFC dated December 17, 1998.
- 10(21) Agreement between Georgian Oil Refinery Company and CanArgo Petroleum Products Ltd. dated September 26, 1998.

- 10(22) Terrenex Acquisition Corporation Option regarding CanArgo (Nazvrevi) Limited.
- 21 List of Subsidiaries.
- 23(1) Consent of PricewaterhouseCoopers LLP
- 23(2) Consent of Ernst & Young LLP, Chartered Accountants, Calgary, Canada.

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- 23(3) Consent of Ernst & Young, Chartered Accountants, Limassol, Cyprus.
 - 23(4) Consent of AMH Group Ltd.
 - 23(5) Consent of Kelly Lytton Mintz & Vann LLP, contained in Exhibit 5(1).
 - 24 Power of Attorney - contained on page S-9 of the Registration Statement.
 - 27 Financial Data Schedules - filed with Edgar version only.

(b) No financial statement schedules are required to be filed herewith.

Item 17. Undertakings

The Company hereby undertakes:

(1) To file, during any period in which offers or sales of the Common Stock are being made, a post-effective amendment to this registration statement:

(i) to include any prospectus required by Section 10(a)(3) of the Securities Act of 1933, as amended (the "Securities Act");

(ii) to reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and

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(iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Company pursuant to the Company's Bylaws, contract or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Calgary, Alberta, Canada, on February 12, 1999.

CANARGO ENERGY CORPORATION

By: /S/ David Robson

David Robson,
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature follows constitutes and appoints each of MICHAEL BINNION and SUSAN E. PALMER, and either of them, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as the undersigned might or could do in person, and hereby ratifying and confirming all that said attorney-in-fact, or his or her substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the date indicated.

<TABLE>

<CAPTION>

| Signature | Title | Date |
|------------------|-------------------------------|-------------------|
| ----- | ----- | ---- |
| <S> | <C> | <C> |
| /S/ David Robson | Chief Executive Officer and | February 12, 1999 |
| ----- | Director (Principal Executive | |

David Robson

Officer)

/S/ Michael Binnion

President, Chief Financial
Officer and Director (Principal
Financial Officer)

February 12, 1999

Michael Binnion

Director

February 12, 1999

Robert A. Halpin

</TABLE>

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<TABLE>

<S>

<C>

<C>

/S/ J.F. Russell Hammond

Director

February 12, 1999

J.F. Russell Hammond

/S/ Peder Paus

Director

February 12, 1999

Peder Paus

/S/ Nils N. Trulsvik

Director

February 12, 1999

Nils N. Trulsvik

/S/ Anthony J. Potter

Controller (Principal
Accounting Officer)

February 12, 1999

Anthony J. Potter

</TABLE>

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CANARGO ENERGY CORPORATION

FORM S-1 REGISTRATION STATEMENT

Exhibit Index

Filed

Herewith

Management Contracts, Compensation Plans and Arrangements are identified by an asterisk (*)

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Filed
Herewith

investors in August 1994, including Directors (Incorporated herein by reference from August 31, 1994 Form 10-KSB, filed by Electromagnetic Oil Recovery, Inc., the Company's predecessor).

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- X 23(4) Consent of AMH Group Ltd.
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- X 24 Power of Attorney - contained on page S-9 of the Registration Statement.
- X 27 Financial Data Schedules - Filed with Edgar version only.

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<DOCUMENT>
<TYPE>EX-10.17
<SEQUENCE>2
<DESCRIPTION>WORKORDER BETWEEN CANARGO ENERGY INC AND ALFRED
<TEXT>

<PAGE> 1

EXHIBIT 10(17)

WORKORDER
CanArgo Energy Inc.
(CanArgo)
to

Alfred Kjemperud
(The Consultant)

INTRODUCTION

This workorder made on the 1 August 1998, is between CanArgo and the Consultant. The workorder is covered by the General Conditions for Consultants entered by the two parties.

SCOPE OF WORK

The scope of work for the Consultant is:

- Assist in developing Canargo's present and future oil and gas assets worldwide

The Consultant's home base will be Oslo, Norway, but he will be travelling frequently for shorter stays to Canargo's operational companies.

The Consultant will report to:

- David Robson

The Assignment is 80% of a full time job, i.e. on average 126 hours per month, and a total of 1510 hours for the defined time period.

PERIOD

1 August 1998 - 31 July 1999.

TERMS

The Consultant will be paid a monthly fee of US\$ 13,000-. The rate includes all normal office expenses the Consultant may have, except for travel, accommodation & other expenses as given below.

PAYMENT

CanArgo will pay the Consultant based on a monthly invoice and time sheets approved by David Robson or other CanArgo project leader. Payment is due 10 working days after receipt of invoice.

1

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TRAVEL, ACCOMODATION & OTHER EXPENSES

Travel, accommodation and courier and other agreed out of pocket expenses related to the above work will be covered by CanArgo according to General Conditions for Consultants.

OTHER ISSUES

Based on Board approval the Consultant shall be entitled to a stock option of 100,000 shares in the merged Fountain Oil/CanArgo company. The options shall be issued as soon as possible and no later than August 1 1998. The price of the options shall be the best possible.

TAXES

The Consultant is responsible for his own taxes.

INSURANCE

The Consultant will himself pay for the insurances and social security which are necessary during his consultancy work period for CanArgo, except for Life & AD&D in areas of particular high risk.

DISPUTES

The agreement shall be governed by the laws of Norway.

CANARGO ENERGY INC.

/s/David Robson

Date: 4/6/98

FOR THE CONSULTANT:

/s/Alfred Kjemperud

Date: 29/5 - 98

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<SEQUENCE>3

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EXHIBIT 10(18)

CONFORMED COPY

INVESTMENT NUMBER 8138

=====

CONVERTIBLE LOAN AGREEMENT

BETWEEN

NINOTSMINDA OIL COMPANY

AND

INTERNATIONAL FINANCE CORPORATION

DATED DECEMBER 17, 1998

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AGREEMENT, dated December 17, 1998 between NINOTSMINDA OIL COMPANY, a company organized and existing under the laws of Cyprus (the "Company"), and INTERNATIONAL FINANCE CORPORATION, an international organization established by Articles of Agreement among its member countries ("IFC").

1

DEFINITIONS AND INTERPRETATION

Section 1.01. General Definitions. Wherever used in this Agreement, unless the context otherwise requires, the following terms have the meanings opposite them:

"Affiliate"

any entity of which the Company is a Subsidiary; or any entity in whose share capital the Company, any entity of which the Company is a Subsidiary, or any of their respective Subsidiaries has a direct or indirect interest exceeding ten percent (10%);

"Agreement on Pledge of Interest and Deed of Pledge"

the Agreement on Pledge of Interest and Deed of Pledge dated as of even date herewith between IFC and the Company and witnessed by Georgian Oil, the state oil company of Georgia;

"Assignment of Contractual Rights, Security Agreement and Financing Statement"

the Assignment of Contractual Rights, Security Agreement and Financing Statement dated as of even date herewith between IFC and the Company and witnessed by Georgian Oil and GBOC;

"Auditors"

PriceWaterhouseCoopers or such other firm of independent public accountants as the Company, with IFC's consent, from time to time appoints as its auditors;

| | |
|--------------------------------|--|
| "Authority" | any government or governmental, administrative, fiscal, judicial, or government-owned, body, department, commission, authority, tribunal, agency or entity; |
| "Authorization" | any consent, registration, filing, agreement, notarization, certificate, license, approval, permit, authority or exemption from, by or with any Authority, whether given by express action or deemed given by failure to act within any specified time period and all corporate, creditors' and stockholders' approvals or consents; |
| "Bank" | United States Trust Company, a New York bank, with which the Debt Service Reserve Account and Revenue Account required under this Agreement have been established and are held; |
| "Business Day" | a day when banks are open for business in New York, New York and, for the purpose of determining the Loan Interest Rate, London, England as well; |
| "Conversion Option" | the right of IFC to convert the Loan into shares as described in Article IV; |
| <PAGE> 7 | |
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| "Conversion Period" | the period beginning on the date of the first Disbursement and ending on the third monthly anniversary of the Physical Completion Date; |
| "Conversion Price" | subject to any adjustment made in accordance with the provisions of Article IV, the price payable by IFC for the Conversion Shares under the Conversion Option which will be an amount determined on a pro-rata basis, assuming that if IFC determined to convert the entire Loan, it would obtain 20% of the Shares on a fully diluted basis; using for purposes of such calculation, the number of issued and outstanding Shares reflected on the Company's latest audited financial statements; |
| "Conversion Settlement Date" | the date on which the Conversion Option shall be effected and the Conversion Shares shall be issued, sold and delivered to IFC, which date shall be a Business Day that is not less than twenty nor more than thirty (30) days after the date of the Notice of Exercise; |
| "Conversion Shares" | the Shares to be acquired by IFC pursuant to the terms of the Notice of Exercise; |
| "Debt Service Reserve Account" | the account established with the Bank and |

designated by such name pursuant to the Security Agreement (Debt Service Reserve Account);

"Debt Service Reserve Account Requirement"

an amount equal to the aggregate of all scheduled amounts of principal, interest and fees payable in respect of the Loan during the next six months required to be maintained in the Debt Service Reserve Account;

"Deed of Adherence"

the Deed of Adherence dated as of even date herewith by and among IFC, the Sponsors and the Immediate Shareholders;

"Disbursement"

any disbursement of the Loan;

"Dollars" and the sign "US\$" or "\$"

the lawful currency of the United States of America;

"Dow Jones Screen Page "

the display of interest settlement rates (commonly known as LIBOR) for Dollar deposits in London designated as page 3750 on the Dow Jones Markets Service (or any other page that replaces page 3750 and displays London interbank settlement rates for Dollar deposits);

"Event of Default"

any one of the events specified in Section 7.02;

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"Field Development Plan"

the Field Development Plan substantially in the form attached as Schedule 9 hereto or as otherwise acceptable to IFC, prepared by the Company and covering the full development plans for the Ninotsminda, Manavi and West Rustavi License area in form and substance reasonably acceptable to IFC;

"Financial Plan"

the proposed sources of financing for the Project set out in Section 2.02(b);

"Financial Completion Date"

the date (following the Physical Completion Date) on which IFC advises the Company in writing that the Company's Financial Completion Notice is acceptable (which acceptance is in IFC's sole reasonable discretion), such notice to be delivered within 10 days of IFC's receipt of the Company's Financial Completion Notice;

"Financial Completion Notice"

a written notice from the Company, signed by an authorized representative of the Company, together with relevant supporting information, as applicable, stating and

providing evidence to the effect that:

- (a) the Debt Service Reserve Account is at least equal to the Debt Service Reserve Account Requirement, as certified by the Bank;
- (b) the following ratios are met, as certified by the Auditors and/or the Independent Reserves Engineer, as applicable and if so requested by IFC:
 - (i) the Current Ratio is at least 1.3;
 - (ii) the Debt Service Coverage Ratio is at least 1.6;
 - (iii) no single Life of Loan Cover Ratio, calculated for each year from the date of calculation until maturity of the Loan, is less than 1.6; and
 - (iv) the Debt to Equity Ratio does not exceed 50:50;
- (c) all of the unspent portion of the funds received by the Company under the Financial Plan are deposited in the Revenue Account;
- (d) no Event of Default or Potential Event of Default has occurred or is continuing;
- (e) no legal or administrative action in any court or tribunal is pending or, to the Company's knowledge, threatened which would materially and adversely affect the Project;

"Fiscal Year"

the accounting year of the Company commencing each year on January 1 and ending on the following December 31, or such other period (of at least 52 consecutive

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weeks) as the Company, with IFC's consent, from time to time designates as its accounting year;

"Gas Sale Agreement"

the gas sales agreements between the Company and purchasers named therein, in form and substance reasonably satisfactory to IFC;

"Government Consent"

the consent of the Georgian Government to the IFC financing as contemplated under this Agreement and acknowledgement of the security arrangements provided by the Company to IFC in connection therewith;

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| "Guaranty" | the several guaranty (pursuant to separate Guaranty Agreements) from each Sponsor (based on and up to its pro-rata ownership interest in the Company plus an assumed pro-rata share of the ownership interest in the Company held by any person other than the Sponsors) of the Loan and all other amounts payable under this Agreement, in effect until the Financial Completion Date; |
| "Hedging Facility" | any agreement between the Company and a counterpart, setting forth a framework for, or terms and conditions of, one or more Hedging Transactions between the Company and such counterpart or any of its Affiliates, which is approved in writing by IFC; |
| "Hedging Transaction" | any option agreement, swap agreement, cap agreement, collar agreement, futures contract, spot contract, forward contract or similar arrangement or combination of any of the foregoing with respect to interest rates, currencies, oil, natural gas or other commodities; |
| "IFC Security" | the security created by or pursuant to the Security Documents to secure all amounts owing by the Company to IFC under this Agreement; |
| "Immediate Shareholders" | each of the CanArgo Limited and JKX Nederlands B.V.; |
| "Independent Engineer" | the petroleum engineering or other consulting entity appointed by IFC following consultation with the Company, for the purpose of advising IFC on Project petroleum reserves and for such other reviews and certifications as required under the terms of this Agreement; |
| "Interest Determination Date" | the second Business Day before the beginning of each Interest Period; |
| "Interest Payment Date" | any day which is June 15 or December 15 in any year, provided that, if any such day is not a Business Day, the Interest Payment Date which would otherwise fall on that day shall fall on the immediately succeeding Business Day; |
| "Interest Period" | each six (6) month period beginning on an Interest Payment Date and ending on the day immediately before the next following Interest Payment Date; except in the case |

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of the first period applicable to each Disbursement when it shall mean the period

beginning on the date on which that Disbursement is made and ending on the day immediately before the next following Interest Payment Date;

"Lien"

any mortgage, pledge, charge, assignment, hypothecation, security interest, title retention, preferential right, trust arrangement, right of set-off, counterclaim or bankers lien, privilege or priority of any kind having the effect of security, any designation of loss payees or beneficiaries or any similar arrangement under or in respect of any insurance policy or any preference of one creditor over another arising by operation of law;

"Loan"

the loan specified in Section 3.01(a) or, as the context requires, its principal amount outstanding from time to time;

"Loan Interest Rate"

or any Interest Period, the rate at which interest is payable on the Loan during that Interest Period, determined in accordance with Section 3.03;

"Maintenance Amount"

the amount certified in the Maintenance Amount Certification to be the net incremental costs of or reduction in return of IFC in connection with the making or maintaining of the Loan which result from:

- (i) any change in any applicable law or regulation or directive (whether or not having force of law) or in its interpretation or application by any Authority charged with its administration; or
- (ii) compliance with any request from, or requirement of, any central bank or other monetary or other Authority;

which in any case, after the date of this Agreement:

- (A) imposes, modifies or makes applicable any reserve, special deposit or similar requirements against assets held by, or deposits with or for the account of, or loans by IFC;
- (B) imposes a cost on IFC as a result of IFC having made the Loan or reduces the rate of return on the overall capital of IFC which it would have achieved, had IFC not made the Loan, as the case may be;
- (C) changes the basis of taxation on payments received by IFC in respect of the Loan (otherwise

than by a change in taxation of the overall net income of IFC imposed by the jurisdiction of its incorporation or in any political subdivision of any such jurisdiction); or

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- (D) imposes on IFC any other condition regarding the making or maintaining of the Loan;

"Maintenance Amount Certification"

a certification furnished from time to time by IFC certifying:

- (i) the circumstances giving rise to the Maintenance Amount;
- (ii) that the costs of IFC, have increased or the rate of return of IFC has been reduced;
- (iii) that, in the opinion of IFC it has exercised reasonable efforts to minimize or eliminate such increase or reduction as the case may be; and
- (iv) the Maintenance Amount;

"Makoil License Transfer Agreement"

the agreement between the Company and Makoil Inc. dated November 10, 1995;

"Minimum Work Program"

the Company's work program, substantially in the form of Schedule 10 attached hereto or otherwise as reasonably satisfactory to IFC, which will include: (a) drilling, completion and testing of at least five development wells on the Ninotsminda field, (b) workovers on the Ninotsminda and West Rustavi fields, (c) equipment and facilities required for the increase of oil and gas production on the Ninotsminda and West Rustavi fields, and (d) seismic acquisition and interpretation required specifically for the Ninotsminda field and for the planning of workovers on the West Rustavi field. The Minimum Work Program shall exclude any activities relating to: (x) the assessment and exploration of the Manavi prospect, (y) drilling and exploration work in the West Rustavi area other than the workovers and related activities described (b) above, and (z) any activities funded by the Company which are carried out for any other parties on a reimbursable basis. The Minimum Work Program shall also exclude any activities carried out prior to January 1, 1998, and any activities subsequent to the

successful completion and testing of five development wells on the Ninotsminda field (all of which will have been drilled after January 1, 1998). For the purposes of assessing the cost of the Minimum Work Program, expenditures which were committed to by the Company prior to January 1, 1998 shall be excluded.

"NOC Administration
Overhead Charges"

all payments made by the Company for services related to the regular operating expenses of the Project that are not specifically allowable and recoverable under Section II of Annex C of the PSC, except for payments to GBOC for regular operating expenses of the Project, payments directly required (i.e. excluding payments permitted) by the other Transaction Documents, and payments directly required under the Makoil License Transfer Agreement;

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"NOC Direct Overhead
Charges"

all payments made by the Company for services related to the regular operating expenses of the Project that are specifically allowable and recoverable under Section II of Annex C of the Production Sharing Contract between the Company and Georgian Oil ("PSC"), except for payments to GBOC for regular operating expenses of the Project, payments directly required (i.e. excluding payments permitted) by the other Transaction Documents, and payments directly required under the Makoil License Transfer Agreement;

"Notice of Exercise"

the notice issued by IFC pursuant to Section 4.02;

"Operator or GBOC"

Georgia British Oil Company (GBOC);

"Permitted Investments"

any of the following:

- (i) investments in direct obligations of the United States of America or obligations of any instrumentality or agency thereof, the payment of the principal and interest of which is unconditionally and timely guaranteed by the United States, in each case having a maturity not in excess of 12 months from the date of its acquisition;
- (ii) investments in certificates of deposit or time deposits maturing not more than 12 months from the date of acquisition issued by any bank or trust company having a combined

capital, surplus and undivided profits of not less than US\$100,000,000 and having a minimum long term credit rating by an internationally recognized independent rating service of at least A (in the case of Standard & Poor's Rating Services or Moody's Investors Service) or its equivalent;

"Physical Completion Date"

the day on which IFC advises the Company in writing that the Company's Physical Completion Notice is acceptable, (which acceptance is in IFC's sole reasonable discretion) such notice to be delivered within 10 days of IFC's receipt of the Company's Physical Completion Notice ;

"Physical Completion Notice"

a written notice from the Company, signed by an authorized representative of the Company together with relevant supporting information, as applicable, stating and providing evidence, concurred with in writing by the Independent Reserves Engineer if so required by IFC, to the effect that:

(i) the Project facilities have been constructed, installed, re-entered, recompleated, tested and commissioned in accordance with the Minimum Work Program;

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(ii) the Project facilities and all other facilities in the Ninotsminda and West Rustavi fields have been constructed and are operating in accordance with good international oil industry practices and IFC's environmental, health and safety guidelines and policies as well as those of the applicable Georgia Authorities;

(iii) production from the Ninotsminda, Manavi and West Rustavi License area shall have averaged 4,500 barrels of crude oil per day, of which at least 4,200 barrels of crude oil per day shall have come from the Ninotsminda field, over a period of at least 90 days within the six months prior to the Physical Completion Date, or the Minimum Work Program is complete;

(iv) the Company shall have supplied to IFC an updated calculation, based on the latest available information and

performed less than four months previously, of the present value (discounted at the Discount Rate) of all future volumes and Net Cash Flows from the proven and proven and probable, oil reserves of the Ninotsminda oil field, including the assumptions and other relevant information underlying such calculation;

"Potential Event of Default"

any event or circumstance which would, with notice, lapse of time, the making of a determination or any combination thereof, become an Event of Default;

"Project"

the project described in Section 2.01;

"Put Option Agreement"

the Put Option Agreement dated as of even date herewith between IFC and the Sponsors;

"Relevant Portion of the Loan"

the portion (up to 100%, at IFC's election) of the Loan which IFC opts to convert and apply as payment for the Conversion Price upon exercise of its Conversion Option;

"Revenue Account"

the account established with the Bank and designated by such name pursuant to the Security Agreement (Revenue Account);

"Rig Service Contract"

the Rig Service Contract between the Company and CanArgo Energy Corporation in form and substance acceptable to IFC;

"Security Documents"

the following agreements:

- (i) the Security Agreement (Accounts Receivable);
- (ii) the Security Agreement (Debt Service Reserve Account)

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- (iii) the Security Agreement (Revenue Account)
- (iv) the Guaranty Agreements;
- (v) the Share Pledge Agreement;
- (vi) the Agreement on Pledge of Interest and Deed of Pledge;
- (vii) the Assignment of Contractual Rights, Security Agreement and Financing Statement;

(viii) the Government Consent;

"Settlement Place" the place or places designated in the Notice of Exercise as being the place or places where the actions specified in Section 4.04 as taking place on the Settlement Date are to be performed;

"Shareholder Loans" the loans from the Sponsors or their Affiliates to the Company (other than the Sponsor Loan) in the aggregate outstanding principal amount of \$2,765,380 as of December 31, 1997;

"Share Pledge Agreement" the Share Pledge Agreement dated as of even date herewith by and among IFC, the Company and the Immediate Shareholders;

"Share Retention Agreement" the Share Retention Agreement dated as of even date herewith by and among IFC, the Company, the Immediate Shareholders and the Sponsors;

"Sponsors" each of CanArgo Energy Corporation and JKC Oil & Gas plc.;

"Sponsor Loan" the subordinated loan in the amount of two million Dollars (US\$2,000,000) granted by the Sponsors to the Company pursuant to the Sponsor Loan Agreement on substantially the terms and conditions set forth in Schedule 8;

"Sponsor Loan Agreement" the Sponsor Loan Agreement dated as of even date herewith between the Sponsors and the Company;

"Subsidiary" in respect of any person, any entity:

- (i) over 50% of whose capital is owned, directly or indirectly, by that person;
- (ii) for which that person may nominate or appoint a majority of the members of the board of directors or other governing body or persons performing similar functions; or

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- (iii) which is otherwise effectively controlled by that person;

"Transaction Documents" the following Agreements and other documents;

- (i) this Agreement;
- (ii) the Security Documents;

- (iii) the Share Retention Agreement;
- (iv) the Put Option Agreement;
- (v) the Deed of Adherence;
- (vi) the Sponsor Loan Agreement;
- (vii) the Minimum Work Program;
- (viii) the Field Development Plan;
- (ix) the Gas Sales Agreement and the Rig Service Contract;
- (x) the Production Sharing Contract between the Company and Georgian Oil dated February 15, 1996;
- (xi) the Complex License granted by the Republic of Georgia to Georgia Makoil Joint Venture dated December 1994;
- (xii) the Mineral Use License granted by the Republic of Georgia to GBOC;
- (xiii) the re-registration of the GBOC license in the name of GBOC-Ninotsminda dated [July 1998];
- (xiv) charter documents of GBOC - Ninotsminda.

Section 1.02. Financial Definitions. Wherever used in this Agreement, unless the context otherwise requires, the following terms have the meanings opposite them:

| | |
|--------------------------------------|--|
| "Current Assets" | the aggregate of the Company's cash, marketable securities, trade and other receivables realizable within one year, prepaid expenses which are to be charged to income within one year and inventories; |
| <p><PAGE> 16</p> <p>- 11 -</p> | |
| "Current Liabilities" | the aggregate of all liabilities of the Company falling due on demand or within one year (including the portion of Long-term Debt falling due within one year); |
| "Current Ratio" | the result obtained by dividing Current Assets by Current Liabilities; |
| "Debt" | the aggregate of all obligations (whether actual or contingent) of the Company to pay or repay money including, without limitation: <ul style="list-style-type: none"> (i) all Indebtedness for Money Borrowed; |

- (ii) the aggregate amount then outstanding of all liabilities of any party to the extent the Company guarantees them or otherwise obligates itself to pay them to the relevant creditor;
- (iii) all liabilities of the Company (actual or contingent) under any conditional sale or a transfer with recourse or obligation to repurchase, including, without limitation, by way of discount or factoring of book debts or receivables;

"Debt to Equity Ratio"

the ratio of Long-term Debt (excluding the portion of Long-term Debt falling due within one year) to Shareholders' Equity;

"Debt Service Coverage Ratio"

as of the relevant date of calculation, the ratio obtained by dividing (i) Net Cash Flow for the immediately preceding four quarters by (ii) all scheduled payments (whether or not actually paid) on account of principal and interest and charges on all Long-term Debt for the immediately succeeding four quarters;

"Discount Rate"

the higher of 10% per annum or the Loan Interest Rate;

"Indebtedness for Money Borrowed"

all obligations of the Company to repay money including, without limitation, in respect of:

- (i) borrowed money;
- (ii) the outstanding principal amount of any bonds, notes, loan stock, commercial paper, acceptance credits, debentures and bills or promissory notes drawn, accepted, endorsed or issued by the Company;
- (iii) any credit to the Company from a supplier of goods or under any installment purchase or other similar arrangement in respect of goods or services (except trade accounts payable within ninety (90) days in the ordinary course of business);

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- (iv) non-contingent obligations of the Company to reimburse any other person in respect of amounts paid by such person under a letter of credit or similar instrument (excluding any such letter of credit or similar instrument issued for the benefit of

the Company in respect of trade accounts payable within ninety (90) days in the ordinary course of business);

- (v) amounts raised under any other transaction having the financial effect of a borrowing and which would be classified as a borrowing (and not as an off-balance sheet financing) under internationally generally accepted accounting principles consistently applied including, without limitation, under leases or similar arrangements entered into primarily as a means of financing the acquisition of the asset leased; and
- (vi) any premium payable on a redemption or replacement of any of the foregoing obligations;

"Life of Loan Cover Ratio"

as of the relevant date of calculation, the ratio obtained by dividing (i) the present value, discounted at the Discount Rate, of future Net Cash Flows from the proven oil reserves of the Ninotsminda oil field from the date of calculation to the date of final maturity of the Loan, by (ii) the amount of principal outstanding of all Long-term Debt. The projections for this calculation shall be based upon the latest reserves valuation submitted to a recognized securities exchange or to IFC, or an equivalent independent valuation to be obtained at IFC's option, and on the most recently published World Bank oil price and inflation forecasts;

"Net Asset Value"

the net present value, discounted at the Discount Rate, of future Net Cash Flows of all probable reserves (risked at 50%) and all proven reserves, plus Current Assets, plus non-exploration and production fixed assets, less liabilities excluding related party debt; the calculation of Net Cash Flows being based on the latest valuation submitted to a recognized securities exchange, or an equivalent independent valuation to be obtained at IFC's option.

"Net Cash Flow"

for any period, Operating Cash Flow less the Company's proportionate share of Project capital development expenses.

"Operating Cash Flow"

for any period, the sum of all proceeds from the sale of the Company's share of oil and natural gas, less the Company's proportionate share of operating costs, operating overheads, royalties, transportation costs and taxes.

"Long-term Debt"

that part of the Debt the final maturity of which, by its terms or the terms of any agreement relating to it, falls due more than

one year after the date of its incurrence;

"Shareholders'
Equity"

the amount paid up on the share capital of the Company (including, without limitation, any share premium account and capital redemption reserve funds); after

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deducting from such amount any impairment of the issued share capital of the Company, amounts set aside for dividends or taxation (including deferred taxation) or attributable to goodwill or other intangible assets;

"Short-term Debt"

all Debt other than Long-term Debt; and

"Working Capital"

the amount by which Current Assets exceed Current Liabilities.

Section 1.03. Interpretation. In this Agreement, unless the context otherwise requires:

(a) headings are for convenience only and do not affect the interpretation of this Agreement;

(b) words importing the singular include the plural and vice versa;

(c) a reference to a natural person includes any company, partnership, trust, joint venture, association, corporation or other body corporate and any governmental authority or agency;

(d) a reference to a Section, Article, party, Exhibit, Annex or Schedule is a reference to that Section or Article of, or that party, Exhibit, Annex or Schedule to, this Agreement;

(e) a reference to a document includes an amendment or supplement to, or replacement or novation of, that document but disregarding any amendment, supplement, replacement or novation made in breach of this Agreement; and

(f) a reference to a party to any document includes that party's successors and permitted assigns.

Section 1.04. Business Day Adjustment. Where the day on or by which a payment is due to be made is not a Business Day, that payment shall be made on or by the next succeeding Business Day. Interest, fees and charges (if any) shall continue to accrue for the period from the due date which is not a Business Day to that next succeeding Business Day.

ARTICLE II

THE PROJECT, PROJECT COST AND FINANCIAL PLAN

Section 2.01. The Project. The project to be financed consists of the further development of the Ninotsminda field, through the drilling of five development wells over an eighteen month period, the installation of processing and handling facilities, and the carrying out of related work on oil and natural gas within the Ninotsminda, Manavi and West Rustavi License area.

Section 2.02. Project Cost and Financial Plan. (a) The estimated cost of the Project is as follows:

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<TABLE>
<CAPTION>

| Project Cost | US\$ Million |
|------------------------------|--------------|
| ----- | ----- |
| <S> | <C> |
| Development wells | 13.0 |
| Workovers | 2.0 |
| Facilities | 1.4 |
| Working Capital | 1.1 |
| Interest During Construction | 0.5 |
| Contingencies | 0.9 |
| TOTAL | 18.9 |

</TABLE>

(b) The proposed sources of financing for the Project are as follows:

<TABLE>
<CAPTION>

| Financing Plan | US\$ Million |
|--|--------------|
| ----- | ----- |
| <S> | <C> |
| IFC Loan | 6.0 |
| Sponsors' Equity (escrowed) | 8.0 |
| Sponsor Loan (escrowed) | 2.0 |
| Cash Generation (or additional equity) | 2.9 |
| TOTAL | 18.9 |

</TABLE>

ARTICLE III

THE LOAN

Section 3.01. The Loan. On the terms and subject to the conditions of this Agreement, IFC agrees to lend to the Company a convertible loan in the amount of up to six million Dollars (US\$6,000,000).

Section 3.02. Disbursement Procedure. (a) The Company may request disbursements of the Loan by delivering to IFC, at least fifteen (15) Business Days prior to the proposed date of disbursement, a disbursement request substantially in the form of Schedule 1 and a receipt substantially in the form of Schedule 2.

(b) IFC shall make Disbursements to the credit of Northern Trust International Banking Corporation (Chips ID 142255) in New York for further credit to the Revenue Account.

(c) Each Disbursement shall be made in an amount (except with respect to the last Disbursement) of not less than one and one-half million Dollars (US\$1,500,000).

Section 3.03. Loan Interest. Subject to Section 3.04, the Company shall pay interest on the Loan in accordance with this Section 3.03.

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(a) During each Interest Period, the Loan (or, in respect of the first Interest Period of each Disbursement, the amount of that Disbursement) shall bear interest at the rate as determined under subsection (c) or (d) below for that Interest Period.

(b) Interest on the Loan shall accrue from day to day, be prorated on the basis of a 360-day year for the actual number of days in the relevant Interest Period and be payable in arrears on the Interest Payment Date immediately following the end of that Interest Period.

(c) The interest payable on the Loan for any Interest Period shall be three percent (3%) per annum above the rate which appears on the Dow Jones Markets, Inc. Page in the column headed "USD" as of 11:00 a.m., London time, on the Interest Determination Date for that Interest Period for six months (or, in the case of the first Interest Period for any Disbursement, for one month, two months, three months or six months, whichever period is closest to the duration of the relevant Interest Period (or, if two periods are equally close, the longer one)) rounded upward to the nearest three decimal places.

(d) If, for any reason, IFC cannot determine the Interest Rate for any Interest Period from the Dow Jones Markets, Inc. Page (whether as a result of the discontinuation of Dow Jones Markets, Inc. Page or otherwise), IFC shall notify the Company and instead determine that Interest Rate using the arithmetical average (rounded upward to the nearest three decimal places) of the offered rates advised to IFC by any three major banks active in the eurodollar interbank market in London selected by IFC after consultation with the Company and otherwise in accordance with subsection (c) above.

(e) On each Interest Determination Date for any Interest Period, IFC shall, in accordance with the relevant subsection above, determine the Loan Interest Rate applicable to that Interest Period and promptly notify the Company of such rate.

(f) The determination by IFC, from time to time, of the Interest Rates shall be final and conclusive and shall bind the Company (unless the Company shows to IFC's satisfaction that the determination involves clerical error).

Section 3.04. Additional Interest. Without limiting the remedies available to IFC under this Agreement or otherwise, if the Company fails to make any payment of principal or interest (including interest payable pursuant to this Section) on or before its due date as specified in this Agreement (whether scheduled, upon voluntary prepayment, mandatory prepayment, at stated maturity or upon prematuring by acceleration or otherwise) or, if not so specified, as notified by IFC to the Company, the Company shall pay in respect of the amount of such payment due and unpaid, interest at the rate of two percent (2%) per annum plus the Loan Interest Rate in effect from time to time from the date any such payment became due until the date of actual payment (as well after as before judgment). Such interest shall be payable on demand, or if not demanded, on each Interest Payment Date after such failure.

Section 3.05. Repayment. (a) The Company shall repay the Loan on the following dates and in the following amounts:

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<TABLE>
<CAPTION>

| | Date Payment Due ----- | Principal Amount Due ----- |
|-----|---------------------------|-------------------------------|
| <S> | | <C> |
| | December 15, 2001 | \$1,200,000 |
| | June 15, 2002 | 1,200,000 |
| | December 15, 2002 | 1,200,000 |
| | June 15, 2003 | 1,200,000 |
| | December 15, 2003 | 1,200,000 |

</TABLE>

(b) Upon each Disbursement, the amount disbursed shall be allocated for repayment on each of the respective dates for repayment of principal set out in the tables in the above subsections in amounts which are pro rata to the amounts of the respective installments shown opposite those dates in those tables (with IFC adjusting those allocations as necessary so as to achieve whole numbers in each case).

Section 3.06. Prepayment. The Loan is not subject to prepayment and may not be voluntarily prepaid by the Company.

Section 3.07. Conversion. The Loan may be converted at IFC's option into shares of the Company in accordance with the provisions of Article IV.

Section 3.08. Fees. (a) The Company shall pay to IFC a commitment fee at the rate of one-half of one percent (1/2%) per annum on that part of the Loan which from time to time has not been disbursed or canceled. The commitment fee shall begin to accrue on the date of this Agreement, be pro rated on the basis of a 360-day year for the actual number of days elapsed, and be payable semi-annually, in arrears, on the Interest Payment Dates in each year, with the first such payment to be due on the immediately succeeding Interest Payment Date following the date hereof.

(b) The Company shall also pay to IFC a front-end fee of one percent (1%) of the aggregate amount of the Loan, to be paid within thirty (30) days after the date of this Agreement, but in any event prior to the date of the first Disbursement;

Section 3.09. Currency and Place of Payments. (a) The Company shall make all payments of principal, interest, fees, and any other amount due to IFC under this Agreement in Dollars, in same day funds, at such bank or banks in New York as IFC from time to time designates.

(b) The tender or payment of any amount payable under this Agreement (whether or not by recovery under a judgment) in any currency other than Dollars shall not novate, discharge or satisfy the obligation of the Company to pay in Dollars all amounts payable under this Agreement except to the extent that (and as of the date when) IFC actually receives Dollars in its account in New York.

(c) If a currency other than Dollars is tendered or paid (or recovered under any judgment) and the amount IFC receives at its designated account in New York falls short of the full amount of Dollars owed to IFC, then the Company shall continue to owe IFC, as a separate obligation, the amount of the shortfall (regardless of any judgment for any other amounts due under this Agreement).

(d) Notwithstanding subsections (a) through (c) above, IFC may require the Company to pay (or reimburse IFC) in any currency other than Dollars for:

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(i) any taxes and other amounts payable under Section 6.05; and

(ii) any fees, costs and expenses payable under Section 9.03;

to the extent those taxes, amounts, fees, costs, and expenses are payable in that other currency.

Section 3.10. Allocation of Partial Payments. If IFC shall at any time receive less than the full amount then due and payable to it under this Agreement, IFC may allocate and apply such payment in any way or manner and for such purpose or purposes under this Agreement as IFC in its sole discretion determines, notwithstanding any instruction that the Company may give to the contrary.

Section 3.11. Maintenance Amount. On each Interest Payment Date, the Company shall pay, in addition to interest, the amount which IFC from time to time notifies to the Company in a Maintenance Amount Certification as being the aggregate Maintenance Amount of IFC accrued and unpaid prior to that Interest Payment Date.

Section 3.12. Funding Costs. (a) If the Company fails to pay any amount due under this Agreement on its due date, or fails to borrow in accordance with a request for disbursement made pursuant to Section 3.02 and as a result IFC incurs any cost, expense or loss, then the Company shall immediately pay to IFC the amount which IFC from time to time notifies to the Company as being the amount of such costs, expenses and losses incurred.

(b) For the purposes of this Section, "costs, expenses or losses" include any interest paid or payable to carry any unpaid amount and any premium, penalty or expense incurred to liquidate or obtain third party deposits or borrowings in order to make, maintain or fund all or any part of the Loan (but in the case of a late payment, after taking into account any additional interest received under Section 3.04).

Section 3.13. Suspension or Cancellation of Disbursements by IFC. (a) IFC may, by notice to the Company, suspend or cancel the right of the Company to Disbursements:

- (i) if the first Disbursement has not been made by June 30, 1999, or such other date as the parties agree;
- (ii) if any Event of Default has occurred and is continuing or if the Event of Default specified in Section 7.02 (d) is, in the reasonable opinion of IFC, imminent;
- (iii) if at any time in the reasonable opinion of IFC, there exists any situation which indicates that performance by the Company, the Immediate Shareholders, or the Sponsors of any of their respective obligations under the Transaction Documents cannot be expected; or
- (iv) on or after June 30, 2000.

(b) Upon the giving of any such notice, the right of the Company to any further Disbursement shall be suspended or canceled as the case may be. The exercise by IFC of its right of suspension shall not preclude IFC from exercising its right of cancellation, either for the same or any other reason specified in subsection (a) above. Upon such cancellation the Company shall pay

to IFC all fees and other amounts accrued (whether or not then due

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and payable) under this Agreement up to the date of such cancellation. A suspension shall not limit any other provision of this Agreement.

Section 3.14. Taxes. (a) The Company shall pay or cause to be paid all present and future taxes, duties, fees and other charges of whatsoever nature, if any, now or in the future levied or imposed by Georgia or by any Authority of Georgia or any jurisdiction through or out of which a payment is made on or in connection with the payment of any and all amounts due under this Agreement.

(b) All payments of principal, interest and other amounts due under this Agreement shall be made without deduction for or on account of any such taxes, duties, fees or other charges.

(c) If the Company is prevented by operation of law or otherwise from making or causing to be made such payments without deduction, the principal or (as the case may be) interest or other amounts due under this Agreement shall be increased to such amount as may be necessary so that IFC receives the full amount it would have received (taking into account any such taxes, duties, fees or other charges payable on amounts payable by the Company under this subsection) had such payments been made without such deduction.

(d) If subsection (c) above applies and IFC so requires, the Company shall deliver to IFC official tax receipts evidencing payment (or certified copies of them) within thirty (30) days of the date of payment.

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ARTICLE IV

CONVERSION OPTION

Section 4.01. The Conversion Option. On the terms and subject to the conditions of this Agreement, the Company hereby grants to IFC an option, which may be exercised once only, to convert, at any time during the Conversion Period and at the Conversion Price, all or any part of the principal amount then outstanding of the Loan into issued, outstanding and fully paid Shares.

Section 4.02. Exercise of the Conversion Option. The Conversion Option may be exercised by IFC delivering a Notice of Exercise specifying:

- (i) the amount of the Loan to be converted into Shares;
- (ii) the Settlement Date;
- (iii) the Settlement Place;

- (iv) the name or names in which the certificate of title evidencing ownership of the Conversion Shares are to be registered;
- (v) the Conversion Price;
- (vi) the number of Conversion Shares that IFC is entitled to upon the conversion; and
- (vii) the amount of accrued but unpaid interest, and any other amount accrued but unpaid, in respect of the amount of the Loan to be converted, which shall become due and payable to IFC on the Settlement Date.

Section 4.03. Actions to be Taken by the Company. Immediately upon receipt of the Notice of Exercise, the Company shall take all necessary corporate and other action required to issue, sell and deliver the Conversion Shares to IFC on the Settlement Date; and shall apply for all the necessary consents and approvals of the requisite governmental authorities in Cyprus and Georgia, as applicable, in connection with the conversion of the Loan to equity.

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Section 4.04. Settlement. On the Settlement Date:

(a) IFC shall, against, and subject to, delivery of the documents specified in Subsection (b) below and payment of the amounts specified in Subsection (c) below, pay to the Company the Conversion Price by delivering its release of the Relevant Portion of the Loan;

(b) the Company shall, against delivery of IFC's release referred to in Subsection (a) above, issue to IFC the Conversion Shares and shall also deliver to IFC (or as IFC may direct):

- (i) the share certificate (or certificates) issued by the Company, evidencing that the Conversion Shares are validly issued and properly registered in the name of IFC or its designee and that such registration grants valid title to the Conversion Shares;
- (ii) evidence satisfactory to IFC that:
 - (A) the Conversion Shares are free and clear of liens, charges and encumbrances, and are voting shares ranking pari passu with all existing voting shares in the Company with all of the rights specified in the Memorandum and Articles of Association of the Company; and
 - (B) all necessary corporate formalities in connection with IFC's title to the Conversion Shares and the delivery of the Conversion Shares have been complied with (such evidence to be confirmed by a legal opinion of counsel in Cyprus (and such other relevant jurisdiction) acceptable to IFC, at the Company's expense); and

- (iii) deliver to IFC certified copies of the necessary consents and approvals referred to in Section 4.03.

(c) the Company shall pay to IFC the amount specified in the Notice of Exercise as payable on account of interest on, and all other amounts payable in accordance with the provisions of the Convertible Loan Agreement in respect of, the Loan being converted into the Conversion Shares;

(d) Upon receipt of all documents and evidence referred to in Section 4.04(b) and of payment of the amounts referred to in Section 4.04(c), the Relevant Portion of the Loan shall be deemed to be satisfied in full and the Company shall be released from its obligations in respect thereto.

Section 4.05. Rights Carried by the Conversion Shares. The Conversion Shares shall carry the right to all profits and/or dividends payable on Shares generally to shareholders of record.

Section 4.06. Reporting Obligation. Should any change be proposed in the share capital of the Company or any other action be proposed which could result in an adjustment to the Conversion Price under this Agreement during the Conversion Period, the Company shall provide IFC with a report setting forth the relevant information related to such change(s), including a statement of:

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(a) the consideration expected to be received or receivable by the Company for any additional stock issued or issuable;

(b) the capital immediately before and after such change(s); and

(c) any other information or event relevant to IFC's exercise of the Conversion Option.

Each such report shall be delivered to IFC as promptly as possible but in any event within thirty (30) days from the date the relevant change is proposed, provided that, in any case, such report shall be delivered prior to such change.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

Section 5.01. Representations and Warranties. The Company represents and warrants that:

(a) it is a company duly organized, validly existing and in good standing under the laws of Cyprus; it is registered and in good standing in Georgia and in any other jurisdiction in which it carries on its business and it has the corporate power to own its assets, conduct its business as presently conducted and to enter into, observe and perform its obligations under, the Transaction Documents to which it is a party or will, in the case of any Transaction Document not executed as at the date of this Agreement, when that Transaction Document is executed, have the corporate power to enter into, observe and perform its obligations under that Transaction Document;

(b) each Transaction Document to which it is a party has been, or will be, duly authorized and executed by the Company and constitutes, or will, when executed constitute, a valid and legally binding obligation of the Company, enforceable in accordance with its terms;

(c) neither the making of any Transaction Document to which it is a party nor (when all the consents referred to in Section 6.01(h) have been obtained) the compliance with its terms will conflict with or result in a breach of any of the terms, conditions or provisions of, or constitute a default or require any consent under, any indenture, mortgage, agreement or other instrument or arrangement to which the Company is a party or by which it is bound, or violate any of the terms or provisions of the Company's Memorandum and Articles of Association or any judgment, decree or order or any statute, rule or regulation applicable to the Company;

(d) neither the Company nor any of its property enjoys any right of immunity from set-off, suit or execution in respect of its assets or its obligations under any Transaction Document to which it is a party;

(e) since December 31, 1997, the Company:

- (i) has not suffered any material adverse change in its business prospects or financial condition or incurred any substantial or unusual loss or liability;

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- (ii) has not undertaken or agreed to undertake any substantial or unusual obligation;

(f) the financial statements of the Company for the period ending on December 31, 1997:

- (i) have been prepared in accordance with International Accounting Standards consistently applied, and give a true and fair view of the financial condition of the Company as of the date as of which they were prepared and the results of the Company's operations during the period then ended;
- (ii) disclose all liabilities (contingent or other wise) of the Company, and the reserves, if any, for such liabilities and all unrealized or anticipated losses arising from commitments entered into by the Company (whether or not such commitments have been disclosed in such financial statements);

(g) except for the Transaction Documents to which it is party, the Company is not a party to or committed to enter into, any material contract;

(h) the Company has no outstanding Lien on any of its assets, and no contracts or arrangements, conditional or unconditional, exist for the creation by the Company of any Lien, except for the IFC Security;

(i) all tax returns and reports of the Company required by law to be filed have been duly filed and all tax assessments, fees and other governmental charges upon the Company, or its properties, or its income or assets, which are due and payable, have been paid, other than those presently payable without penalty or interest;

(j) except as previously disclosed in writing to IFC, the Company is not engaged in nor, to the best of its knowledge, threatened by, any litigation,

arbitration or administrative proceedings, the outcome of which might materially and adversely affect its business prospects or financial condition or make it improbable that the Company will be able to observe or perform its obligations under any Transaction document to which it is a party; and

(k) to the best of its knowledge and belief, the Company is not in violation of any statute or regulation of any Authority and no judgment or order has been issued which has or is likely to have any materially adverse effect on the Company's business prospects or financial condition or make it improbable that the Company will be able to observe or perform its obligations under any Transaction Document to which it is a party

Section 5.02. IFC Reliance. (a) The Company acknowledges that it makes the representations and warranties in Section 5.01 with the intention of inducing IFC to enter into this Agreement and that IFC enters into this Agreement on the basis of, and in full reliance on, each of such representations and warranties.

(b) The Company warrants to IFC that each of such representations is true and correct in all material respects as of the date of this Agreement and that none of them omits any matter the omission of which makes any of such representations misleading.

Section 5.03. Rights and Remedies not Limited. IFC's rights and remedies in relation to any misrepresentation or breach of warranty on the part of the Company are not prejudiced:

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(a) by any investigation by or on behalf of IFC into the affairs of the Company;

(b) by the execution or the performance of this Agreement or any other Transaction Document; or

(c) by any other act or thing which may be done by or on behalf of IFC in connection with this Agreement and which might, apart from this Section, prejudice such rights or remedies.

ARTICLE VI

CONDITIONS OF DISBURSEMENT

Section 6.01. Initial Conditions. The obligation of IFC to make the first Disbursement is subject to the fulfillment, in a manner satisfactory to IFC, prior to or concurrently with the making of such first Disbursement, of the following conditions:

(a) Each of the Company, the Sponsors and the Immediate Shareholders has performed all of its respective obligations due to be performed under the Transaction Documents prior to the first Disbursement;

(b) arrangements satisfactory to IFC have been made with respect to the installation and operation of an accounting and cost control system, a management information system, and the appointment of the Auditors;

(c) the Company has insured its properties and business in accordance

with Section 7.03 and has provided to IFC copies of all insurance policies required to be in force as at the date of the first Disbursement together with a certificate of the insurer, insurance broker or agent confirming that such policies are in effect;

(d) the Transaction Documents, each in form and substance satisfactory to IFC, have been entered into by all parties to them and have become (or, as the case may be, remain) unconditional and fully effective in accordance with their respective terms (except for this Agreement having become unconditional and fully effective, if that is a condition of any of such agreements) and, if IFC requires, IFC has received a copy of each Transaction Document to which it is not a party, certified as a true and complete copy by the Company;

(e) the Memorandum and Articles of Association of the Company is in form and substance satisfactory to IFC;

(f) the IFC Security has been duly created and perfected/registered as first priority security interests in all assets subject to the Security Documents;

(g) the Debt Service Reserve Account and the Revenue Account shall have been established with the Bank;

(h) the Company has obtained, or made arrangements satisfactory to IFC for obtaining, all Authorizations for:

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- (i) the Loan;
- (ii) the carrying on of the business of the Company as it is presently carried on and is contemplated to be carried on;
- (iii) the carrying out of the Project and the implementation of the Financial Plan;
- (iv) the due execution, delivery, validity and enforceability of, and performance under, each Transaction Document, and any other documents necessary or desirable to the implementation of any of those Agreements or Documents; and
- (v) the remittance to IFC in Dollars of all monies payable in respect of the Transaction Documents;

and has provided IFC with copies of those Authorizations, certified as true and complete copies by the Company, if IFC so requires;

(i) IFC has received a legal opinion or opinions, in form and substance satisfactory to it, from counsel in Georgia, Cyprus and New York, with respect to:

- (i) the organization, existence and operations of the Company and its authorized and subscribed share capital;
- (ii) the matters referred to in subsections (d), (e), (f), and (h), above;
- (iii) the title of the Company to, or other interest of the Company in, the assets which are the subject of the IFC

Security;

- (iv) the authorization, execution, validity and enforceability of the Transaction Documents and any other documents necessary or desirable to the implementation of any of them;
 - (v) the compliance with all obligations referred to in Sections 3.14 and 7.05;
 - (vi) the priorities or privileges, if any, that creditors of the Company, other than IFC, may have by reason of law; and
 - (vii) such other matters relating to the transactions contemplated by this Agreement as IFC reasonably requests;
- (j) IFC has received:
- (i) (if IFC so requires) the reimbursement of fees and expenses of IFC's counsel as provided in Section 8.03; and

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- (ii) the fees specified in Section 3.08 required to be paid on or before the date of the first Disbursement;

(k) arrangements satisfactory to IFC have been made for appointment of an agent for service of process pursuant to Section 9.06;

(l) IFC has received a copy of the authorization to the Auditors referred to in Section 6.01 (h) and has received from the Auditors a letter or copy of a management letter from the auditor to the Company commenting on the adequacy of the Company's accounting and cost control system, and management information system;

(m) IFC has received evidence, in the form of Schedule 3, of the authority of the person or persons who will, on behalf of the Company, sign the requests and certifications provided for in this Agreement, or take any other action or execute any other document required or permitted to be taken or executed by the Company under this Agreement, and the authenticated specimen signature of each such person;

(n) IFC has received evidence that all Shareholders Loans have been capitalized into Shareholders Equity;

(o) IFC has approved the Gas Sales Agreements and the Company's arrangements for sale of crude oil;

(p) IFC has received evidence of: (i) the amount of new equity contributed by the Sponsors to the company in Fiscal Year 1998 and already spent on the Minimum Work Program; (ii) the amount of new equity contributed by the Sponsors to the Company which has been transferred as a cash balance to the Revenue Account; and (iii) the payment by the Sponsors of the proceeds of the Sponsor Loan into the Revenue Account; and the sum of the foregoing amounts shall be at least ten million Dollars (US\$10,000,000); provided, however, that the requirement under subclause (iii) above shall not be applicable and accordingly, the sum of the foregoing amounts referred to above shall be reduced by the amount of the Sponsor Loan and therefore be equal only to at least eight million Dollars (US\$8,000,000), if an irrevocable letter of credit, in form and substance satisfactory to IFC (including, in this respect, the satisfactory

identity of the financial institution issuing such letter of credit), is obtained and is in full force and effect prior to the date of the first Disbursement, to support the future ability of the Sponsors to disburse the Sponsor Loan following a disbursement request by the Company;

(q) [intentionally omitted];

(r) IFC has received a copy of the Company's audited financial statements for the previous Fiscal Year, as well as copies of the Company's unaudited quarterly financial statements for the period between the date of the audited financial statements and the date of Disbursement;

(s) the Company has appointed a full-time project manager, acceptable to IFC (which acceptance shall not be unreasonably withheld), who will be based mostly in Georgia, and has provided IFC with a copy of such project manager's employment contract;

(t) the Company has supplied IFC with a list of all beneficiaries of past payments from the Company and/or its predecessor (JKX (Ninotsminda)), which IFC agrees to keep strictly confidential;

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Section 6.02. Conditions of all Disbursements. The obligation of IFC to make any Disbursement is also subject to the conditions that:

(a) the Debt to Equity Ratio does not exceed 50:50;

(b) the Life of Loan Cover Ratio exceeds 1.6;

(c) no Event of Default and no Potential Event of Default has occurred and is continuing;

(d) the proceeds of such Disbursement are not in reimbursement of, or to be used for, expenditures in the territories of any country which is not a member of IFC or the World Bank or for goods produced in or services supplied from any such country; but are, at the date of the relevant request, needed by the Company for the purpose of the Project, or will be needed for that purpose within three (3) months of such date and shall be spent only in countries which are members of the World Bank;

(e) since the date of this Agreement nothing has occurred which can reasonably be expected to materially and adversely affect the carrying out of the Project or the Company's business prospects or financial condition or make it improbable that the Company will be able to observe or perform any of its obligations under this Agreement;

(f) since the date of this Agreement the Company has not incurred any material loss or liability (except such liabilities as may be incurred in accordance with Section 6.02); and

(g) the representations and warranties made in Article V are true on and as of the date of that Disbursement with the same effect as if such representations and warranties had been made on and as of the date of that Disbursement (but in the case of Section 5.01 (c), without the words in parenthesis).

(h) all fees due and payable under Section 3.08 shall have been paid in full.

Section 6.03. Company Certification. The Company shall deliver to IFC:

(a) as part of each request for Disbursement a certification, substantially in the form of Schedule 1, with respect to the conditions specified in Sections 6.01 and 6.02, expressed to be effective as of the date of the relevant Disbursement and in the case of Section 6.02 (e), certified by the Auditors if IFC so requires;

(b) such evidence as IFC reasonably requests of the proposed utilization of the proceeds of the relevant Disbursement or the utilization of the proceeds of any prior Disbursement; and

(c) if IFC requests, a legal opinion or opinions in form and substance satisfactory to IFC, of counsel acceptable to IFC, and concurred in by counsel for the Company, with respect to any matters relating to the relevant Disbursement.

Section 6.04. Conditions for IFC Benefit. The conditions in Sections 6.01 through 6.05 are for the benefit of IFC and may be waived only by IFC at its sole discretion.

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Section 6.05. Saving of Rights. Unless IFC otherwise notifies the Company and without limiting the generality of Section 9.10, the right of IFC to require compliance with any condition under this Agreement which IFC waives in respect of any Disbursement shall be preserved for the purposes of any subsequent Disbursement.

ARTICLE VII

PARTICULAR COVENANTS

Section 7.01. Affirmative Covenants. Unless IFC otherwise agrees, the Company shall:

(a) carry out the Project in accordance with the Field Development Plan, subject to such substantial modifications which have been previously approved in writing by IFC, and otherwise conduct its business with due diligence and efficiency and in accordance with sound engineering, financial and business practices;

(b) cause the financing specified in the Financial Plan to be applied exclusively to the Project and use its best efforts to cause the Physical Completion Date to occur before December 31, 1999;

(c) promptly install and/or maintain the accounting and cost control system and management information system referred to in Section 6.01 (b), maintain books of account and other records adequate to reflect truly and fairly the financial condition of the Company and the results of its operations (including the progress of the Project) in conformity with International Accounting Standards, consistently applied;

(d) Maintain a system for marketing and sales of oil produced from the Project satisfactory to IFC and endeavor to find economic markets for all natural gas produced by the Project in excess of requirements for field operations and to sell such natural gas pursuant to a Gas Sales Agreement;

(e) during implementation of the Project, within 20 days of the end of each calendar month commencing with the calendar month following the date of the first Disbursement, deliver to IFC a monthly report, providing project implementation and operations information, including, without limitation, information on production of oil and natural gas from the License Area by field, production and disposal of formation water by field, principal investments and works carried out within the License Area, material works or services contracts entered into, significant events relating to the environment, occupational health and safety matters, and such other information as IFC may reasonably request to be provided on such monthly basis.

(f) as soon as available but in any event within forty-five (45) days after the end of each of the first three quarters of each Fiscal Year, deliver to IFC:

- (i) two (2) copies of the Company's complete financial statements for such quarter prepared in accordance with International Accounting Standards consistently applied, certified by the chief financial officer of the Company;

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- (ii) a calculation of the Debt Service Coverage Ratio as of the first day of such quarter, certified by the chief financial officer of the Company;
- (iii) two (2) copies of a quarterly report, providing operations information, including, without limitation, production of oil and natural gas by well, production of formation water by well, all investments and works carried out within the License Area, contracts for works and services entered into, a complete record of health, safety and environmental incidents, details of all contracts in effect relating to the sale and/or transportation of oil and natural gas from the Project, a record of individual sales including customer, quantities and price of both crude oil or natural gas sold, as well as a report on any factors materially affecting or which might materially affect the Company's business and operations or its financial condition and ability to meet its obligations under any Transaction Document, and such other information as IFC may reasonably request to be provided on such quarterly basis;
- (iv) a statement of all financial transactions between the Company and its directors, each Immediate Shareholder, any other shareholder, each Sponsor, and any other of its Affiliates and a certification by the chief financial officer of the Company that those transactions were on the basis of arms'-length arrangements and competitive bidding in compliance with the requirements of this Agreement;
- (v) a statement of the Company's Indebtedness for Borrowed Money in respect of Hedging Transactions as of the last day of such quarter;

(g) as soon as available but in any event within one hundred and twenty (120) days after the end of each Fiscal Year, deliver to IFC:

- (i) two (2) copies of its complete and audited financial statements for such Fiscal Year (which are in agreement with its books of account and prepared in accordance with International Accounting Standards consistently applied), together with the Auditors' audit report on them, all in form satisfactory to IFC;
- (ii) a copy of any management letter or other communication from the Auditors to the Company or to its management commenting, with respect to such Fiscal Year, on, among other things, the adequacy of the Company's financial control procedures, accounting systems and management information system;
- (iii) (following the Financial Completion Date) a calculation of the Debt Service Coverage Ratio and Debt to Equity Ratio, certified by the chief financial officer of the Company;
- (iv) a report by the Auditors to the effect that, on the basis of its audited financial statements, the Company was in compliance with the financial covenants contained in Section 7.01 (y) as of the end of the relevant Fiscal Year or, as the case may be, detailing any non-compliance;
- (v) a review by the Company of the operations of the Company during such Fiscal Year, in a form satisfactory to IFC, containing the information listed in Schedule 5;

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- (vi) a copy of the latest estimates and evaluation of the Company's proven and probable reserves, as submitted by CanArgo Energy Corporation to the United States Securities and Exchange Commission, or a recognized securities exchange or other securities regulatory authority together with supporting information;
- (vii) a statement by the Company of all financial transactions between the Company and its directors, each Immediate Shareholder, any other shareholder, each Sponsor, and any other of its Affiliates during such Fiscal Year and a certification by the chief financial officer of the Company that those transactions were on the basis of arms'-length arrangements and competitive bidding in compliance with the provisions of this Agreement;
- (viii) a statement of the Company's Indebtedness for Borrowed Money in respect of Hedging Transactions as of the last day of such Fiscal Year;

(h) deliver to IFC, no later than December 1 of each year, a copy of the Project budget for the next Fiscal Year which has been approved by the Company's board of directors;

(i) deliver to IFC, promptly following receipt, a copy of any management letter or other communication sent by the Auditors (or any other accountants retained by the Company) to the Company or its management in relation to the Company's and/or the Project's financial, accounting and other systems, management or accounts if not provided pursuant to subsection (g) (ii) above;

(j) authorize, in the form of Schedule 4, the Auditors (whose fees and expenses shall be for the account of the Company) to communicate directly with IFC at any time regarding the Company's accounts and operations and furnish to IFC a copy of such authorization;

(k) endeavor to notify IFC not less than fifteen (15) days before any meeting of its shareholders, including the agenda of the meeting and permit a representative of IFC, at IFC's discretion, to attend such meeting as an observer;

(l) promptly deliver to IFC two (2) copies of all notices, reports and other communications of the Company to its shareholders and endeavor to promptly deliver to IFC the minutes of all shareholders' meetings;

(m) promptly provide to IFC such information as IFC from time to time reasonably requests about the Company, its assets and the Project;

(n) permit representatives of IFC and the Independent Engineer to visit any of the premises where the business of the Company is conducted and to have access to its books of account and records;

(o) promptly notify IFC of any proposed change in the nature or scope of the Project, the Field Development Plan, the Minimum Work Program, or the business or operations of the Company, and of any event or condition which might materially and adversely affect the carrying out of the Project or the carrying on of the Company's business or operations including, without limitation any Event of Default or Potential Event of Default under any Transaction Document;

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(p) promptly notify IFC as soon as it becomes aware of any litigation or administrative proceedings before any Authority or arbitral body which does or may materially and adversely affect the Company, its assets or the Project or the ability of the Company to perform and observe its obligations under any Transaction Document;

(q) take all actions necessary to comply, and cause the Operator to comply, with (A) the "ecological passport", issued by the Georgian Ministry of Environmental Protection and all other applicable environmental and occupational health and safety requirements of Georgia and any local authorities, (B) applicable World Bank environmental policies, occupational health and safety guidelines, (C) the environmental and social actions specified in the Environmental Review Summary, and (D) the Supplemental Archaeological Policy and Procedures;

(r) [intentionally omitted];

(s) within one hundred and twenty (120) days after the end of each Fiscal Year, deliver to IFC an annual monitoring report, confirming compliance by the Company and by the Operator with the requirements of Section 7.01(r) above or, as the case may be, detailing any non-compliance together with the action being taken to ensure compliance;

(t) maintain a full-time project manager acceptable to IFC, who shall be based mostly in Georgia, and provide to IFC a copy of such project manager's employment contract to the extent materially changed from the prior one submitted to IFC;

(u) if PriceWaterhouseCoopers cease to be the auditors of the Company

for any reason, appoint and maintain as the auditors of the Company a firm of independent public accountants satisfactory to IFC and, within thirty (30) days after such appointment, deliver to IFC a copy of an authorization to such firm in the form of Schedule 4;

(v) obtain and maintain in force (or where appropriate, promptly renew) all Authorizations necessary for carrying out the Project and the Company's business and operations generally and the performance of the Company's obligations under the Transaction Documents;

(w) perform and observe all the conditions and restrictions contained in, or imposed on the Company by, any of the Authorizations referred to in 7.01(v);

(x) grant and assign the IFC Security to IFC and from time to time, execute, acknowledge and deliver, or cause to be executed, acknowledged and delivered, such further instruments as may reasonably be requested by IFC for perfecting or maintaining in full force and effect the perfection of the IFC Security or for re-registering the IFC Security or otherwise to comply with the Company's obligations under the Transaction Documents;

(y) maintain at all times, commencing with the Financial Completion Date:

- (i) a Debt Service Coverage Ratio of at least 1.6;
- (ii) a Current Ratio of at least 1.3; and
- (iii) a Debt to Equity Ratio of less than 50:50;

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(z) maintain the credit balance in the Debt Service Reserve Account at all times equal to the Debt Service Reserve Account Requirement and replenish, if necessary, the balance in such Account within five Business Days of the date on which IFC notifies the Company of the Loan Interest Rate applicable to any Interest Period, provided that, if the balance of the Debt Service Reserve Account is at any time greater than the Debt Service Reserve Account Requirement, the Company may, in a written notice to IFC stating the amount by which the Debt Service Reserve Account is overfunded, request IFC to direct the Bank to transfer the amount of such excess to the Revenue Account, and IFC agrees to give such direction within five Business Days of such request or such later date as shall be specified therein;

(aa) require purchasers of its share of the oil produced from the Project and purchasers of natural gas under any Gas Sales Agreement to make all payments in Dollars on purchases of such oil or natural gas, within 45 days of lifting, to the Revenue Account and if, notwithstanding the Company's directions, a purchaser makes any such payment to any other account of the Company (or of any of the Sponsors or Immediate Shareholders), deposit or cause to be deposited into the Revenue Account an amount equal to that payment;

(bb) use funds available in the Revenue Account only for the following purposes and in the following order of priority, and otherwise subject to the terms and conditions of this Agreement:

- (i) first, to replenish the Debt Service Reserve Account, if required, so that the balance on deposit therein is at all times equal to the Debt Service Reserve Account Requirement;

- (ii) second, regular operating expenses of the Project, including NOC Direct Overhead Charges and NOC Administration Overhead Charges as permitted by Section 7.02(x) and (y);
- (iii) third, to make principal and interest payments on the Loan as and when they come due, and to pay any fees in connection with the Loan as and when they come due;
- (iv) fourth, to meet Project capital expenditure commitments in accordance with the Minimum Work Program;
- (v) fifth, to meet capital expenditure commitments in accordance with the Field Development Plan as modified by the Annual Budgets approved by the Company's Board of Directors;
- (vi) sixth, to any other payment permitted under this Agreement.

Section 7.02. Negative Covenants. Unless IFC otherwise agrees in writing, the Company shall not:

(a) directly or indirectly, declare or pay any dividend or make any distribution on its share capital, or purchase, redeem or otherwise acquire any shares of the Company or any option over them (each such action, a "Restricted Payment"), if an Event of Default or Potential Event of Default has occurred and is continuing;

(b) make any Restricted Payment unless:

- (i) the Financial Completion Date has occurred;

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- (ii) after taking into account and giving effect to each such Restricted Payment, the balance in the Debt Service Reserve Account is at least equal to the Debt Service Reserve Account Requirement;
- (iii) after taking into account and giving effect to each such Restricted Payment, the Debt Service Coverage Ratio, Debt to Equity Ratio and Current Ratio are at the respective levels required under Section 7.01(x);

(c) in any Fiscal Year, make any payment, whether by way of repayment of the Sponsor Loan or otherwise, to any Immediate Shareholder, Sponsor, or any other Affiliate, except to the extent of funds available therefor in the Revenue Account in accordance with Section 7.01(bb) and to the extent permitted under Subsection (b) above, and otherwise in accordance with the provisions of the Transaction Documents;

(d) in any Fiscal Year, incur expenditures or commitments for expenditures for fixed or other non-current assets, other than those required for carrying out the Project or necessary for repairs or replacements essential to the Company's business or operations, in excess of an aggregate amount equivalent to \$500,000;

(e) incur, assume or permit to exist any indebtedness except:

- (i) the Loan;

- (ii) other Indebtedness for Money Borrowed contemplated by the Financial Plan;
- (iii) Short Term Debt incurred in the ordinary course of business in an amount not to exceed \$2,000,000;
- (iv) subordinated shareholder loans on terms and conditions substantially in the form of Schedule 7;

(f) except as permitted under a Hedging Facility, enter into any Hedging Transaction or assume the obligations of any party to any Hedging Transaction;

(g) enter into any agreement or arrangement to guarantee or, in any way or under any condition, to become obligated for all or any part of any financial or other obligation of another person;

(h) create or permit to exist any Lien on any property, revenues or other assets, present or future, of the Company, other than the IFC Security;

(i) enter into any transaction except in the ordinary course of business on the basis of arm's-length arrangements (including, without limitation, transactions whereby the Company might pay more than the ordinary commercial price for any purchase or might receive less than the full ex-works commercial price (subject to normal trade discounts) for its products) and, in the case of transactions with Affiliates, on the basis of competitive bidding;

(j) establish any sole and exclusive purchasing or sales agency;

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(k) enter into any partnership, profit-sharing or royalty agreement or other similar arrangement whereby the Company's income or profits are, or might be, shared with any other person;

(l) enter into any management contract or similar arrangement, whereby its business or operations are managed by any other person;

(m) form or have any Subsidiary;

(n) make or permit to exist loans, advances or investments to or in any person or enterprise, or make or permit to exist deposits with any person or enterprise other than commercial bank deposits in the ordinary course of business which may be invested only in short term investment grade marketable securities acquired solely to give temporary employment to its idle funds, and provided, further, that funds in the Debt Service Revenue Account shall only be invested in Permitted Investments;

(o) change its Memorandum and Articles of Association in any manner which would be inconsistent with the provisions of any Transaction Document;

(p) change its Fiscal Year;

(q) change the nature or scope of the Project or change the nature of its business or operations;

(r) sell, transfer, lease or otherwise dispose of all or a substantial part of its assets (whether in a single transaction or in a series of transactions, related or otherwise) unless such assets are replaced by assets

("Replacement Assets") of the same or higher value and useful economic life and unless, as a condition precedent to any such sale, transfer, lease, or disposition, the Company takes all necessary steps to ensure, and delivers an opinion of counsel acceptable to IFC (if IFC so requires) to the effect that, any Replacement Assets will become part of the IFC Security;

(s) sell, farm-out or otherwise assign to any party its interest under the Production Sharing Contract and/or the Production and Exploration License or any agreement relating thereto;

(t) undertake or permit any merger, consolidation or reorganization;

(u) terminate, amend or grant any waiver in respect of any provision of any Transaction Document;

(v) prepay (whether voluntarily or involuntarily) or repurchase any Long-term Debt (other than the Loan) pursuant to any provision of any agreement or note in respect of that Long-term Debt, unless:

- (i) that Long-term Debt is refinanced using new Long-term Debt on equivalent terms or terms (as to interest rate and tenor) more favorable to the Company; or
- (ii) if IFC so requires, the Company contemporaneously prepays a proportionate amount of the Loan;

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(v) enter into any agreement or arrangement to acquire by lease the use of any property or equipment of any kind, except leases in respect of property or equipment with respect to which the total annual lease payments does not exceed the equivalent of \$1,000,000; or

(w) use the proceeds of any Disbursement in the territories of any country which is not a member of IFC or the World Bank or for reimbursements of expenditures in those territories or for goods produced in or services supplied from those territories.

(x) make any payment of NOC Direct Overhead Charges in any Fiscal Year unless the aggregate of all such payments does not exceed, in Fiscal Year 1998, US\$1.2 million, and in any Fiscal Year thereafter, US\$1.2 million, escalated at 2% annually. Upon request by IFC, the Company shall provide documentation and justification for any payments made in compliance with this Section 7.02(x).

(y) make any payment of NOC Administration Overhead Charges in any Fiscal Year unless the aggregate of all such payments does not exceed, in Fiscal Year 1998, US\$0.5 million, and in any Fiscal Year thereafter, US\$0.5 million, escalated at 2% annually. Upon request by IFC, the Company shall provide documentation and justification for any payments made in compliance with this Section 7.02(y).

Section 7.03. Insurance. Unless IFC otherwise agrees, the Company shall:

(a) insure and keep insured with financially sound and reputable insurer or insurers all its assets and business which can be insured, against all insurable losses, on a reinstatement basis utilizing current full replacement values, including, without limitation, the insurance specified in Schedule 6 and any other insurance required by law; all such insurance policies shall be in the English language and governed by New York law;

(b) punctually pay any premium, commission and any other amounts necessary for effecting and maintaining in force each insurance policy;

(c) ensure that every insurance and reinsurance policy on its assets and for business interruption or delayed start-up cannot be terminated by the insurer for any reason (including failure to pay the premium or any other amount) unless both IFC and the Company receive at least forty-five (45) days notice;

(d) ensure that every insurance policy on its assets which are the subject of the IFC Security and for business interruption or delayed start-up names IFC as sole loss payee for any claim in excess of five hundred thousand Dollars (US\$500,000);

(e) ensure that IFC and all contractors working at the Project site (but only with respect to construction work) are named as additional named insured, on all public liability policies;

(f) not do or omit to do, or permit to be done or not done, anything which might prejudice the Company's, right to claim or recover under any insurance policy;

(g) deliver to IFC:

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(i) within thirty (30) days after any insurance policy is issued to the Company, a copy of that policy incorporating any loss payee provisions required under subsection (d) above (unless that policy has already been provided to IFC pursuant to Section 6.01(c));

(ii) not less than ten (10) days prior to the expiry date of any insurance policy (or, for insurance with multiple renewal dates, not less than ten (10) days prior to the expiry date of the policy on the principal asset), a certificate of renewal from the insurer, insurance broker or agent confirming the renewal of that policy and the renewal period, the premium, the amounts insured for each asset or item and any changes in terms or conditions from the policy's issue date or last renewal and confirmation from the insurer that provisions naming IFC as loss payee remain in effect; and

(iii) any other information or documents on each insurance policy IFC requests from time to time;

(h) notify IFC as soon as possible of any event entitling the Company to claim for an aggregate amount exceeding the equivalent of five hundred thousand Dollars (\$500,000) under any one or more insurance policies;

(i) promptly notify the relevant insurer of any claim by the Company under any policy written by that insurer and diligently pursue that claim; and

(j) not vary, rescind, cancel, terminate or cause a material change to any insurance policy, nor do or omit to do, or permit to be done or not done, anything which might prejudice the Company's right to claim or recover under any insurance policy.

Section 7.04. Application of Insurance Proceeds. (a) At its discretion, IFC may remit the proceeds of any insurance paid to it to the Company to repair or replace the relevant damaged assets or may apply such proceeds to prepay all or any part of the Loan (or any other amounts owing to IFC).

(b) The Company shall use any insurance proceeds it receives (whether from IFC or directly from the insurers) for loss of or damage to any asset solely to replace or repair that asset.

Section 7.05. Document Taxes. (a) The Company shall pay all taxes (including stamp taxes), duties, fees or other charges payable on or in connection with the execution, issue, delivery, registration or notarization of the Transaction Documents, and any other documents related to this Agreement.

(b) The Company shall, upon notice from IFC, reimburse IFC or its assigns for any such taxes, duties, fees or other charges paid by IFC or its assigns.

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ARTICLE VIII

EVENTS OF DEFAULT

Section 8.01. Acceleration after Default. If any Event of Default occurs and is continuing (whether it is voluntary or involuntary, or results from operation of law or otherwise), IFC may, by notice to the Company, require the Company to repay the Loan or such part of the Loan as is specified in that notice. On receipt of any such notice, the Company shall immediately repay the Loan (or that part of the Loan specified in that notice) and all interest accrued on it and any other amounts then payable under this Agreement. The Company waives any right it might have to further notice, presentment, demand or protest in respect of that demand for immediate payment.

Section 8.02. Events of Default. It shall be an Event of Default if:

(a) the Company fails to pay when due any part of the principal of the Loan or any interest on the Loan and such failure continues for a period of five (5) days;

(b) the Company fails to observe or perform any of its obligations under this Agreement (other than for the payment of the principal of, or interest on, the Loan), any other Transaction Document or any other agreement between the Company and IFC, or any other party fails to observe or perform any of its obligations under any Transaction Document, and any such failure continues for a period of fifteen (15) days or, in the case of such a failure with respect to Section 7.01(y) only, thirty (30) days, after IFC notifies the Company of that failure;

(c) any representation or warranty made in Article V, in connection with the execution and delivery of this Agreement, or in connection with any request for Disbursement under this Agreement, or in any other Transaction Document, is found to be incorrect in any material respect;

(d) any Authority condemns, nationalizes, seizes, or otherwise expropriates all or any substantial part of the property or other assets of the Company or of its share capital, or assumes custody or control of such property or other assets or of the business or operations of the Company or of its share

capital, or takes any action for the dissolution or disestablishment of the Company or any action that would prevent the Company or its officers from carrying on all or a substantial part of its business or operations;

(e) a decree or order by a court is entered against the Company:

- (i) adjudging the Company bankrupt or insolvent;
- (ii) approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition of, or in respect of, the Company under any applicable law;
- (iii) appointing a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Company or of any substantial part of its property or other assets; or
- (iv) ordering the winding up or liquidation of its affairs;

or any petition is filed seeking any of the above and is not dismissed within thirty (30) days;

(f) the Company:

- (i) requests a moratorium or suspension of payment of debts from any court;

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- (ii) institutes proceedings or takes any form of corporate action to be liquidated, adjudicated bankrupt or insolvent;
- (iii) consents to the institution of bankruptcy or insolvency proceedings against it;
- (iv) files a petition or answer or consent seeking reorganization or relief under any applicable law, consents to the filing of any such petition or to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Company or of any substantial part of its property;
- (v) makes a general assignment for the benefit of creditors; or
- (vi) admits in writing its inability to pay its debts generally as they become due or otherwise becomes insolvent;

(g) an attachment or analogous process is levied or enforced upon or issued against any of the assets of the Company for an amount in excess of the equivalent of five hundred thousand Dollars (\$500,000) and is not discharged within thirty (30) days;

(h) any other event occurs which under any applicable law would have an effect analogous to any of those events listed in subsections (e), (f) and (g) above;

(i) any of the events specified in subsections (e), (f), (g) and (h) above occur with respect to any Sponsor so long as the Guaranty is in effect;

(j) the Company fails to pay any of its Debt (other than the Loan) which is outstanding under, or to perform any of its obligations under, any

agreement pursuant to which there is outstanding any Debt of the Company in an amount exceeding five hundred thousand Dollars (\$500,000), and such failure continues for more than any applicable period of grace;

(k) any Authorization necessary for the Company to perform and observe its obligations under any Transaction Document is not obtained when required or is rescinded, terminated, lapses or otherwise ceases to be in full force and effect, including in respect of the remittance to IFC or its assigns in Dollars of any amounts payable under any Transaction Document and is not restored or reinstated within thirty (30) days of notice by IFC to the Company requiring that restoration or reinstatement;

(l) any provision of any Security Document is revoked, terminated or ceases to be in full force and effect or ceases to provide the security intended, without, in each case, the prior consent of IFC, or performance of the obligations under any such document becomes unlawful or any such document is declared to be void or is repudiated or its validity or enforceability at any time is challenged by any person unless, in the case only of a repudiation or challenge, such repudiation or challenge is withdrawn within thirty (30) days of IFC's notice to the Company requiring that withdrawal and pending such withdrawal such repudiation or challenge has no effect;

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(m) any provision of any Transaction Document (other than a Security Document) is materially modified, revoked, terminated or ceases to be in full force and effect without, in each case, the prior consent of IFC, or performance of the obligations under any such document becomes unlawful or any such document is declared to be void or is repudiated or its validity or enforceability at any time is challenged by any person and such provision is not restored or replaced by a provision acceptable to IFC, or such repudiation or challenge is not withdrawn within thirty (30) days of IFC's notice to the Company requiring that restoration, replacement or withdrawal and pending such withdrawal such repudiation or challenge has no effect;

(n) if, after the Financial Completion Date, the balance in the Debt Service Reserve Account is lower than the Debt Service Reserve Account Requirement and is not made up to such amount within any time period agreed pursuant to the Retention Account Agreement;

Section 8.03. Bankruptcy. If the Company is liquidated or declared bankrupt, the Loan, all interest accrued on it and any other amounts payable under this Agreement will become immediately due and payable without any presentment, demand, protest or notice of any kind, all of which the Company waives.

Section 8.04. Notice of Events. If any Event of Default or Potential Event of Default occurs, the Company shall immediately notify IFC by facsimile or telex specifying the nature of such Event of Default or Potential Event of Default and any steps the Company is taking to remedy it.

Section 8.05. Disclosure of Information. (a) IFC may disclose to any person for the purpose of exercising any power, remedy, right, authority, or discretion under this Agreement or any other Transaction Document in connection with an Event of Default, any documents or records of, or information about, any Transaction Document, or the assets, business or affairs of the Company.

(b) The Company acknowledges and agrees that, notwithstanding the terms of any other agreement between the Company and IFC, a disclosure of information by IFC in the circumstances contemplated by this Section does not violate any

duty owed to the Company or any agreement between IFC and the Company.

ARTICLE IX

MISCELLANEOUS

Section 9.01. Notices. Any notice, request or other communication to be given or made under this Agreement shall be in writing. Subject to Sections 6.01(m) and 7.05, the notice, request or other communication may be delivered by hand, airmail, facsimile, established courier service or telex to the party's address specified below or at such other address as such party notifies to the other party from time to time and will be effective upon receipt or, in the case of delivery by hand or by established courier service, upon refusal to accept delivery.

For the Company:

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Ninotsminda Oil Company
P.O. Box 291
Commerce House, Les Banques
St. Peter Port, Guernsey, GY1 3RR
British Isles

Attention: Chairman

Facsimile: 44-1481-729-982

With a copy sent to:

Ninotsminda Oil Company
Suite 1580, 727 - 7th Avenue S.W.
Calgary, Alberta, Canada
T2P 0Z5

Attention: Finance Director

Facsimile: (403) 777-1578

For IFC:

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Director, Oil, Gas and Mining Department

Facsimile: (202) 974-4322

With a copy (in the case of notices relating to payments) sent to the attention of the Manager, Accounting Division, at:

Facsimile: (202) 974-4371

Section 9.02. English Language. All documents to be furnished or communications to be given or made under this Agreement shall be in the English language or, if in another language, shall, if IFC so requests, be accompanied by a translation into English satisfactory to IFC certified by a representative of the Company, which translation shall be the governing version between the Company and IFC.

Section 9.03. Expenses. The Company shall pay to IFC or as IFC may direct:

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(a) the fees and expenses of IFC's external counsel in Georgia and New York incurred in connection with:

- (i) the preparation of the investment by IFC provided for under this Agreement;
- (ii) the preparation and/or review, execution and, where appropriate, registration of the Transaction Documents and any other documents related to them;
- (iii) the giving of any legal opinions required by IFC under any Transaction Document;
- (iv) the administration by IFC of the investment provided for in this Agreement or otherwise in connection with any amendment, supplement or modification to, or waiver under, any of the Transaction Documents;
- (v) the registration (where appropriate) and the delivery of the evidences of indebtedness relating to the Loan and its disbursement;
- (vi) the occurrence of any Event of Default or Potential Event of Default; and

(b) the costs and expenses incurred by IFC in relation to the enforcement or protection or attempted enforcement or protection of its rights under any Transaction Document, or the exercise of its rights or powers consequent upon or arising out of the occurrence of any Event of Default or Potential Event of Default, including legal and other professional consultants' fees on a full indemnity basis.

Section 9.04. Financial Calculations. (a) All financial calculations to be made under, or for the purposes of, this Agreement shall be determined in accordance with accounting principles applied on a consistent basis and, except as otherwise required to conform to the definitions contained in Article I or any other provisions of this Agreement, shall be calculated from the then most recently issued quarterly financial statements which the Company is obligated to furnish to IFC under Section 7.01 (f).

(b) If the relevant quarterly financial statements are in respect of the last quarter of a Fiscal Year then, at IFC's option, such calculations may instead be made from the audited financial statements for the relevant Fiscal Year.

(c) If any material adverse change in the financial condition of the Company after the end of the period covered by the relevant financial statements

has occurred, such material adverse change shall also be taken into account in calculating the relevant figures.

Section 9.05. Termination of Agreement. This Agreement shall continue in force until all monies payable under it have been fully paid in accordance with its provisions.

Section 9.06. Applicable Law and Jurisdiction (a) This Agreement is governed by, and shall be construed in accordance with, the laws of the State of New York, United States of America.

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(b) The Company irrevocably agrees that any legal action, suit or proceeding arising out of or relating to this Agreement or any other Transaction Document to which it is party may be brought by IFC in the courts of the State of New York or of the United States of America located in the Southern District of New York. Final judgment against the Company in any such action, suit or proceeding shall be conclusive and may be enforced in any other jurisdiction, by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the judgment, or in any other manner provided by law.

(c) By the execution and delivery of this Agreement, the Company irrevocably submits to the non-exclusive jurisdiction of any such court in any such action, suit or proceeding and designates, appoints and empowers Corporation Services Company, Two World Trade Center, New York, NY as its authorized agent to receive for and on its behalf service of any summons, complaint or other legal process in any such action, suit or proceeding in the State of New York.

(d) Nothing in this Agreement shall affect the right of IFC to commence legal proceedings or otherwise sue the Company in any other jurisdiction, or concurrently in more than one jurisdiction, or to serve process, pleadings and other legal papers upon the Company in any manner authorized by the laws of any such jurisdiction.

(e) As long as this Agreement remains in force, the Company shall maintain a duly appointed agent for the service of summons, complaint and other legal process in New York, New York, United States of America, for purposes of any legal action, suit or proceeding IFC may bring in respect of this Agreement or any other Transaction Document to which it is a party. The Company shall keep IFC advised of the identity and location of their respective agent.

(f) The Company also irrevocably consents, if for any reason its authorized agent for service of process of summons, complaint and other legal process in any such action, suit or proceeding is not present in New York, New York, to service of such papers being made out of those courts by mailing copies of the papers by registered United States air mail, postage prepaid, to the Company's address specified in Section 9.01. In such a case, IFC shall also send by telex or facsimile, or have sent by telex or facsimile, a copy of the papers to the Company.

(g) Service in the manner provided in subsection (f) above in any such action, suit or proceeding will be deemed personal service, will be accepted by the Company as such and will be valid and binding upon the Company for all purposes of any such action, suit or proceeding.

(h) The Company irrevocably waives to the fullest extent permitted by applicable law:

- (i) any objection which it may have now or in the future to the laying of the venue of any such action, suit or proceeding in any court referred to in this Section;
- (ii) any claim that any such action, suit or proceeding has been brought in an inconvenient forum; and
- (iii) its right of removal of any matter commenced by IFC in the courts of the State of New York to any court of the United States of America.

(i) To the extent that the Company may be entitled in any jurisdiction to claim for itself or its assets immunity in respect of its obligations under this Agreement or any other Transaction Document to which it is party

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from any suit, execution, attachment (whether provisional or final, in aid of execution, before judgment or otherwise) or other legal process or to the extent that in any jurisdiction such immunity (whether or not claimed) may be attributed to it or its assets, the Company irrevocably agrees not to claim and irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction.

(j) The Company hereby acknowledges that IFC shall be entitled under applicable law, including the provisions of the International Organizations Immunities Act, to immunity from a trial by jury in any action, suit or proceeding arising out of or relating to this Agreement or the transactions contemplated hereby or any other Transaction Document to which it is a party, brought against IFC in any court of the United States of America. The Company hereby waives any and all rights to demand a trial by jury in any action, suit or proceeding arising out of or relating to this Agreement or any other Transaction Document to which it is a party or the transactions contemplated by this Agreement or such Transaction Documents, brought against IFC in any forum in which IFC is not entitled to immunity from a trial by jury.

(k) To the extent that the Company may, in any suit, action or proceeding brought in any of the courts referred to in paragraph (b) above or elsewhere arising out of or in connection with this Agreement or any other Transaction Document to which it is party, be entitled to the benefit of any provision of law requiring IFC in such suit, action or proceeding to post security for the costs of the Company (*cautio judicatum solvi*), or to post a bond or to take similar action, the Company hereby irrevocably waives such benefit, in each case to the fullest extent now or in the future permitted under the laws of the jurisdiction in which such court is located.

Section 9.07. Successors and Assigns. This Agreement binds and benefits the respective successors and assigns of its parties. However the Company may not assign or delegate any of its rights or obligations under this Agreement without IFC's consent.

Section 9.08. Amendment. Any amendment of any provision of this Agreement shall be in writing and signed by the parties.

Section 9.09. Counterparts. This Agreement may be executed in several counterparts, each of which is an original, but all of which together constitute one and the same agreement.

Section 9.10. Remedies and Waivers. No failure or delay by IFC in exercising any power, remedy, discretion, authority or other rights under this Agreement shall waive or impair that or any other right of IFC. No single or

partial exercise of such a right shall preclude its additional or future exercise. No such waiver shall waive any other right under this Agreement. All waivers or consents given under this Agreement shall be in writing.

IN WITNESS WHEREOF, the parties have caused this Agreement to be signed in their respective names as of the date first above written.

NINOTSMINDA OIL COMPANY

By: /s/ MICHAEL BINNION

Authorized Representative

INTERNATIONAL FINANCE CORPORATION

By: /s/ MARIA DA GRACA DOMINGUES

Authorized Representative

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SCHEDULE 1
Page 1 of 3

FORM OF REQUEST FOR DISBURSEMENT [(LOAN)]
(See Sections 3.02 and [6.06])
[COMPANY LETTERHEAD]

[Date]

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Director, Oil, Gas and Mining Department

Ladies and Gentlemen:

Investment No. 8138
Request for Loan Disbursement No. []*

1. Please refer to the Convertible Loan Agreement (the "Convertible Loan Agreement") dated December 17, 1998 between Ninotsminda Oil Company (the "Company") and International Finance Corporation ("IFC"). Terms defined in the Convertible Loan Agreement have their defined meanings whenever used in this

request.

2. The Company irrevocably requests the disbursement on _____, 1998 (or as soon as practicable thereafter) of the amount of _____ (_____) under the Loan (the "Disbursement") in accordance with the provisions of Section 3.02 of the Convertible Loan Agreement. You are requested to pay such amount to the account in [New York] of [Name of Company], Account No. _____ at [Name and Address of Bank].

- - - - -

* To correspond with number of the Disbursement Request. SEC Schedule 1.

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SCHEDULE 1
Page 2 of 3

3. There is enclosed a signed[, stamped,] but undated receipt for the amount of the Disbursement. The Company authorizes IFC to date such receipt with the date of actual disbursement by IFC.

4. For the purpose of Sections [6.02 and 6.03] of the Convertible Loan Agreement, the Company further certifies as follows:

(a) no Event of Default and no Potential Event of Default has occurred and is continuing;

(b) the proceeds of the Disbursement are at the date of this request needed by the Company for the purpose of the Project, or will be needed for such purpose within three (3) months of such date;

(c) since the date of the Convertible Loan Agreement nothing has occurred which might materially and adversely affect the carrying out of the Project or the Company's business prospects or financial condition, or make it improbable that the Company will be able to fulfill any of its obligations under the Convertible Loan Agreement;

(d) since [insert date] [the date of the Convertible Loan Agreement] the Company has not incurred any material loss or liability (except such liabilities as may be incurred by the Company in accordance with Section 7.02 of the Convertible Loan Agreement);

(e) the representations and warranties made in Article VI of the Convertible Loan Agreement are true on the date of this request and will be true on the date of Disbursement with the same effect as if such representations and warranties had been made on and as of each such date;

(f) the proceeds of that Disbursement are not in reimbursement of, or to be used for, expenditures in the territories of any country which is not a member of IFC or the World Bank or for goods produced in or services supplied from any such country;

(g) after giving effect to the Disbursement, the Company will not be in violation of:

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SCHEDULE 1
Page 3 of 3

- (i) its [Memorandum and Articles of Association]/[Charter];
- (ii) any provision contained in any document to which the Company is a party (including the Convertible Loan Agreement) or by which the Company is bound; or
- (iii) any law, rule or regulation, directly or indirectly, limiting or otherwise restricting the Company's borrowing power or authority or its ability to borrow; and

The above certifications are effective as of the date of this Request for Disbursement and shall continue to be effective as of the date of the Disbursement. If any of these certifications is no longer valid as of or prior to the date of the requested Disbursement, the Company undertakes to immediately notify IFC.

Yours truly,

NINOTSMINDA OIL COMPANY

By _____
Authorized Representative

Copy to: Manager, Accounting Division
International Finance Corporation

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SCHEDULE 2
Page 1 of 1

FORM OF LOAN DISBURSEMENT RECEIPT

(See Section 3.02 of the Convertible Loan Agreement)

[COMPANY LETTERHEAD]

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Manager, Accounting Division

Ladies and Gentlemen:

Investment No. 8138
Disbursement Receipt No. []* (Loan)

We, Ninotsminda Oil Company, hereby acknowledge receipt on the date hereof, of the sum of \$_____ disbursed to us by International Finance Corporation ("IFC") under the Loan of \$_____ provided for in the Convertible Loan Agreement dated December 17, 1998 between our company and International Finance Corporation.

Yours truly,

NINOTSMINDA OIL COMPANY

By _____
Authorized Representative**

- -----
** To correspond with number of the Disbursement request. See Schedule 1.

*** As named in the Company's Certificate of Incumbency and Authority (see Schedule [4]).

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SCHEDULE 3
Page 1 of 2

FORM OF CERTIFICATE OF INCUMBENCY AND AUTHORITY
(See Section [5.01(n)])

[COMPANY LETTERHEAD]

[Date]

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Director, Oil, Gas and Mining Department

Ladies and Gentlemen:

Certificate of Incumbency and Authority

With reference to the Convertible Loan Agreement between us, dated December 17, 1998 (the "Convertible Loan Agreement"), I, the undersigned [Chairman/Director] of Ninotsminda Oil Company, (the "Company"), duly authorized to do so, hereby certify that the following are the names, offices and true specimen signatures of the persons each of whom are, and will continue to be, authorized:

(a) to sign on behalf of the Company the requests for the disbursement of funds provided for in Section [3.02] of the Convertible Loan Agreement;

(b) to sign the certifications provided for in Section 6.03 of the Convertible Loan Agreement; and

(c) to take any other action required or permitted to be taken, done, signed or executed under the Convertible Loan Agreement or any other agreement to which IFC and the Company may be parties.

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SCHEDULE 3
Page 2 of 2

| * Name | Office | Specimen Signature |
|--------|--------|--------------------|
| _____ | _____ | _____ |
| _____ | _____ | _____ |
| _____ | _____ | _____ |

You may assume that any such person continues to be so authorized until you receive authorized written notice from the Company that they, or any of them, is no longer so authorized.

Yours truly,

NINOTSMINDA OIL COMPANY

By _____
[Chairman/Director]

- - - - -

** Designations may be changed by the Company at any time by issuing a new certificate of Incumbency and Authority authorized by the Board of Directors of the Company.

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SCHEDULE 4
Page 1 of 2

FORM OF LETTER TO COMPANY'S AUDITORS

[COMPANY LETTERHEAD]

(See Sections [5.01(m)] and [6.01(h)] of
the Convertible Loan Agreement)

[DATE]

[NAME OF AUDITORS]
[ADDRESS]

Ladies and Gentlemen:

We hereby authorize and request you to give to International Finance Corporation of 2121 Pennsylvania Avenue, N.W., Washington, D.C. 20433, United States of America ("IFC"), all such information as IFC may reasonably request with regard to the financial statements of the undersigned Company, both audited and unaudited. We have agreed to supply that information and those statements under the terms of an Convertible Loan Agreement between the undersigned Company and IFC dated December 17, 1998 (the "Convertible Loan Agreement"). For your information we enclose a copy of the Convertible Loan Agreement.

We authorize and request you to send two copies of the audited accounts of the undersigned Company to IFC to enable us to satisfy our obligation to IFC under Section [6.01 (e)(i)] of the Convertible Loan Agreement. When submitting the same to IFC, please also send, at the same time, a copy of your full report on such accounts in a form reasonably acceptable to IFC.

Please note that under Section [6.01 (e) (ii) and (iii)] of the Convertible Loan Agreement, we are obliged to provide IFC with:

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(a) a copy of any management letter or other communication from you to the Company or its management commenting on, among other things, the adequacy of the Company's financial control procedures and accounting and management information systems; and

(b) a report by you certifying that, based upon its audited financial statements, the Company was in compliance with the financial covenants contained in Section [6.02] of the Convertible Loan Agreement as at the end of the relevant Fiscal Year or, as the case may be, detailing any non-compliance.

Please also submit each such communication and report to IFC with the audited accounts.

For our records, please ensure that you send to us a copy of every letter which you receive from IFC immediately upon receipt and a copy of each reply made by you immediately upon the issue of that reply.

Yours truly,

NINOTSMINDA OIL COMPANY

By _____
Authorized Representative

Enclosure

cc: Director
[Name of Department]
International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

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INFORMATION TO BE INCLUDED IN ANNUAL REVIEW OF
OPERATIONS

(See Section 7.01(f)(v) of the Convertible Loan Agreement)

- [1] Sponsors and Shareholdings. Information on significant changes in share ownership of Company, the reasons for such changes, and the identity of major new shareholders.

- 2) Country Conditions and Government Policy. Report on any material changes in local conditions, including government policy changes, that directly affect the Company (e.g. changes in government economic strategy, taxation, foreign exchange availability, price controls, and other areas of regulations.)
- 3) Management and Technology. Information on significant changes in (i) the Company's senior management or organizational structure, and (ii) technology used by the Company, including technical assistance arrangements.
- 4) Corporate Strategy. Description of any changes to the Company's corporate or operational strategy, including changes in products, degree of integration, and business emphasis.
- 5) Markets. Brief analysis of changes in Company's market conditions (both domestic and export), with emphasis on changes in market share and degree of competition.
- 6) Operating Performance. Discussion of major factors affecting the year's financial results (sales by value and volume, operating and financial costs, profit margins, capacity utilization, capital expenditure, etc.).
- 7) Financial Condition. Key financial ratios for previous year, compared with ratios covenanted in the Convertible Loan Agreement.]

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[SCHEDULE 6]
Page 1 of 1

INSURANCE REQUIREMENTS

The company shall effect and maintain the following insurance covers at all times during the period of the Financing Agreements, under forms of policies and with insurers and reinsurers acceptable to IFC:

1. Property insurance covering all assets at full replacement value during operations and construction (as applicable).
2. Business Interruption cover with minimum 12 months indemnity period.
3. Liability cover, including products liability and seepage and pollution for not less than US\$ 10 million.
4. Operator's Extra Expenses, including Control of Well, Redrilling, etc. for not less than US\$ 10 million.
5. Transport insurance for import of equipment, oil in transit, etc.
6. All other insurances required by local legislation or by contract.

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[SCHEDULE 7]

Page 1 of 2

TERMS OF SUBORDINATED LOANS

Any subordinated loan provided to the Company, (except for the Sponsor Loan), shall have the following minimum terms:

(a) unsecured;

(b) repayment in approximately equal semi-annual installments over a period of not less than five (5) years commencing twelve (12) months after the full disbursement of the relevant Subordinated Loan;

(c) rate of interest not to exceed that of the IFC Loan;

(d) no payment of interest or repayment of principal in respect of the Subordinated Loan shall be made in any Fiscal Year unless all amounts due and payable by the Company to IFC in that Fiscal Year have been fully paid;

(e) no payment of interest or repayment of principal in respect of the Subordinated Loan shall be made if the Company is in arrears in the payment of interest on, or repayment of principal of, the IFC Loan or any other indebtedness;

(f) payment of principal and interest shall take place at least fifteen (15) days after the Interest Payment Dates of the IFC Loan;

(g) upon any distribution of assets in connection with any dissolution, winding up, liquidation, bankruptcy, reorganization or upon an assignment for the benefit of creditors of the Company:

(i) no payment in respect of principal, interest or any other amount in respect of such Subordinated Loans may be made unless full payment in respect of interest on, and principal of, the IFC Loan has been made;

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SCHEDULE 7

Page 2 of 2

(ii) any payment or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to which the lender of the Subordinated Loan would be entitled in respect of the Subordinated Loan except for these provisions, must instead be paid by the liquidator or agent or other person making such payment or distribution, whether a trustee in bankruptcy, a receiver or liquidating trustee or other trustee or agent, directly to IFC; and

(h) until all amounts payable in respect of the IFC Loan, or otherwise under the Convertible Loan Agreement, are paid in full the lenders of the Subordinated Loan shall not:

- (i) exercise or attempt to exercise any right of subrogation with respect to payments not paid to such lenders as a result of the operation of the provisions set forth in this Schedule 1;
- (ii) claim or receive the benefit of any document or agreement of which IFC has the benefit, any monies held by IFC or any right, power or authority of IFC;

(i) if for any reason whatsoever the lender of such Subordinated Loan receives any payment or distribution in respect of the Subordinated Loan contrary to the provisions set out above, that lender shall hold the same in trust for IFC, promptly notify IFC of the receipt of such payment or distribution and promptly pay the amount of such payment or distribution to IFC or, if IFC so elects, to any bank specified by IFC, to hold such amounts for IFC's account.

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SCHEDULE 8
Page 1 of 1

REQUIREMENTS FOR SPONSOR LOAN

The Sponsor Loan will be provided, or caused to be provided, by the Sponsors to the Company prior to Loan Disbursement. The Sponsor Loan will be in the amount of US\$2 million, and shall be unsecured and subordinated to the Loan. The Sponsor Loan will be disbursed into the Revenue Account. It will accrue interest at the Loan Interest Rate until the Physical Completion Date, after which time no further interest shall accrue. No payments of interest or repayments of principal shall be made until after the Physical Completion Date, after which time principal of the Sponsor Loan and accrued interest may be repaid providing that (i) after giving effect to such repayment the Debt Service Reserve Account is funded at the Debt Service Reserve Account Requirement and (ii) no Event of Default or Potential Event of Default has occurred or is continuing.

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SCHEDULE 9

Field Development Plan

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NINOTSMINDA OIL COMPANY LIMITED
1580, 727 - SEVENTH AVENUE S.W.,
CALGARY, ALBERTA T2P 0Z5

TELEPHONE : (403) 777-1185
FACSIMILE : (403) 777-1578

Updated Field Development Plan

for the Ninotsminda Oil Field

Proposed Plans for 1998 and 1999

&

A General Full Field Development Plan

Prepared By

Irakli Tavdumadze
Alfred Kjemperud
Ingo McGrath

Tbilisi, Georgia

October 1998

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Ninotsminda Oil Company
Updated Field Development Plan

Wednesday, February 10, 1999

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Wednesday, February 10, 1999

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Ninotsminda Oil Company

Wednesday, February 10, 1999

Updated Field Development Plan

1 SUMMARY

This document is an addendum to the report: "Field Development plan for the development of the Ninotsminda Oilfield, Republic of Georgia." sent to IFC in the spring of 1998. The purpose of this document is twofold; first, to present a summary of Ninotsminda Oil Company's (NOC) 1998 operations to September, 1998 and second, to detail a "Minimum Work Program" for the next 15 months until the end of 1999.

The work to be performed in Ninotsminda can either be regarded as appraisal, development or maintenance. All tasks are interrelated when it comes to sharing of resources, equipment and personnel and all three parts will be covered in this document without distinctions between them.

The IFC Loan requirements include a "Minimum Work Program" which is estimated to cost \$US 18.9 M. With respect to this requirement, NOC has set a production goal of 4,500 bopd by December 1999. As per the IFC loan, 1998 sunk costs directly related to the project will be reviewed and included as part of NOC's capital cost requirement. Past production, seismic, drilling and workovers will be presented. Future seismic, drilling, workovers and facility upgrade will be performed. Generally, future works will include four measures for an estimated \$US 15.4 M. These include:

- - Drilling 5 wells
- - Performing 5 major workovers
- - Doing production maintenance and upgrading facilities
- - Shooting 30 km of new seismic, purchasing old lines, reprocessing all lines and interpreting all data

Five new wells will be drilled, with the first being a vertical and the second being horizontal and the remaining three horizontals drilled on a contingent basis subject to technical and commercial results of the first two. If all five are drilled, NOC expects an initial production increase of 4,050 bopd for an estimated cost of \$US 12.9 million.

The major workovers include gas and water isolation, reperforating new pay, and

selective treatment of new pay. The 5 major workovers are expected to cost \$US 373,000 and result in a production increase of 1,075 bopd.

Workovers, routine de-waxing and oil squeezes were done and will continue to be performed. Pipelines were replaced, new lines installed, drill pipe and rig equipment was purchased. Upgrading of facilities and equipment will be continued. The cost for routine well, facility and equipment maintenance is estimated to be \$US 2.2 mm.

NOC's plan calls for the purchase of 20 km of old seismic lines, reprocessing of 137 km and the shooting of 30 km of new lines for \$US 277,000. PVT and Pressure Transient

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Ninotsminda Oil Company

Wednesday, February 10, 1999

Updated Field Development Plan

equipment and analysis will complete the reservoir analysis work for \$US 50,000. Better definition of reservoir parameters will be obtained.

An extension to the Minimum Work Program is Future Field Development. Together the two plans result in 9 more wells to be drilled; one vertical, 4 horizontal and 15 laterals from the last four wells. The expected cost is \$US 35 mm and will result in a peak production of 17,000 bopd in 2001 and recover 50 mmbo by the year 2016.

2 SEISMIC PROGRAM

2.1 OLD SEISMIC DATA

There are 73 km of old seismic lines crossing the NOC license that are recommended for reprocessing. In addition, approximately 20 km of lines was shot over NOC license area in the late 80s that were never processed. It is recommended that this data be acquired and added to the database.

Tables 1 & 2 below show the lines recommended for purchase and reprocessing by NOC.

| AREA | LINE # | LENGTH km. |
|--------------|--------|------------|
| Ninotsminda | 029302 | 13 |
| Ninotsminda | 029304 | 14 |
| Ninotsminda | 029605 | 8 |
| Manavi | 068528 | 3 |
| Manavi | 068527 | 3 |
| Manavi | 068412 | 3 |
| West Rustavi | 118701 | 11 |
| West Rustavi | 118703 | 18 |
| TOTAL | | |

TABLE 1 OLD SEISMIC DATA RECOMMENDED FOR REPROCESSING

| AREA | LINE # | LENGTH km. |
|--------------|--------|------------|
| West Rustavi | 018901 | 14 |
| West Rustavi | 018906 | 8 |
| West Rustavi | 018908 | 13 |
| West Rustavi | 018903 | 15 |
| West Rustavi | 018803 | 14 |
| TOTAL * | | 64 |

TABLE 2 OLD NON-PROCESSED SEISMIC RECOMMENDED FOR PURCHASE AND PROCESSING

* NOC share is 21 km

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2.2 NEW SEISMIC LINES

10 km of new seismic will cross the Ninotsminda Oil Field. The lines will all run north to south along the dip of the structure. Another 20 km of seismic will be shot in the West Rustavi area. It is planned to shoot these lines with a vibroseis unit.

The cost of the operation allocated to NOC is presented below in Table 3.

2.3 SUMMARY OF SEISMIC ACTIVITIES

The table below shows the activity and cost.

<TABLE>

<CAPTION>

SEISMIC WORKS

LENGTH

COST TO

NOC \$US

(NOC LICENSE ONLY)

km

- - - - -

--

<S>

<C>

<C>

MOBILIZATION/DEMOB.

37,400

SEISMIC ACQUISITION @ \$US 4942/km

30

148,260

PROCESSING @ \$US 600/DAY

10

6,000

PURCHASE OF NON-PROCESSED OLD SEISMIC

21*

10,000

PROCESSING OF NON-PROCESSED OLD DATA @ \$US 200/km

21

4,200

REPROCESSING OF EXISTING DATA @ \$US 200/km

73

14,600

CREW SUPERVISION, SUPERVISION OF PROCESSING AND REPROCESSING AND

11

6,600

INTERPRETATION @ \$US 600/DAY

TOTAL

227,060

CONTINGENCY

49,940

TOTAL

277,000

</TABLE>

TABLE 3 SUMMARY OF COST OF SEISMIC ACQUISITION, PROCESSING AND INTERPRETATION
(* NOC share only (1/3 of total))

3 DRILLING PROGRAM

3.1 GENERAL

Drilling of two wells, N97 and N98 are planned for 1998. Three more contingent wells N99, N100 and N105 are planned in 1999. Two refurbished Ural Mash 3E rigs will drill the wells. The schedule for the drilling program is illustrated in Figure 3.

There are several purposes for these wells:

- - To increase oil production
- - To delineate the reservoir unit to the east,
- - To prove horizontal and lateral well applicability,

- - To increase the proven reserves,
- - To determine reservoir characteristics,
- - To determine production characteristics,

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- - To determine drainage characteristics and
- - To compare results of vertical and horizontal wells.

The expected oil rate for vertical wells is 650 bopd and 850 bopd for horizontal wells. An upside potential is 750 and 1400 bopd respectively. It is expected that the wells will produce fairly constantly for 18 months to 2 years and then decline at 15% per year. Horizontal wells will decline at a lower rate because the drainage is from a larger area and at less drawdown pressures. Other well details are given on Table 4, below:

<TABLE>

<CAPTION>

| WELL # CONSTANT RATE MONTHS | FRACTURE FREQUENCY | POSSIBILITY OF LAUMONITE | RISK FACTOR OF PRODUCTION | THICKNESS OF OIL LEG m | EXPECTED RATE bopd | UPSIDE bopd |
|-----------------------------------|-----------------------|-----------------------------|------------------------------|---------------------------|-----------------------|----------------|
| - - - - - | - - - - - | - - - - - | - - - - - | - - - - - | - - - - - | - - - - - |
| <S> <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| 97 18 | High | High | low | 300 | 850 | 1400 |
| 98 18 | High | High | low | 380 | 650 | 750 |
| 99 18 | High | Average | medium | 300 | 850 | 1300 |
| 100 18 | High | Average | medium | 170 | 850 | 1300 |
| 105 18 | High | High | low | 380 | 850 | 1400 |
| TOTAL | | | | | 4,050 | 6,150 |

TABLE 4 NEW WELLS: ESTIMATED RESERVOIR PROPERTIES AND RISKS

3.2 WELL N98

N98 is currently being drilled in the vicinity of wells N22, N49 and N52 in the east and central part of the field. (Figure 2) N98 was spudded in August 12, 1998, and by Oct 1st had reached 2650m. Planned TD is 3,100m, just below the prognosed OWC in the Middle Eocene volcanoclastic deposits. The expected initial production is 650 bopd. The drilling time is estimated to be 85 days and the cost to 2.5 million \$US.

The well has penetrated the following stratigraphic units:

- 0-280m - Pliocene
- 280-930m - Upper Sarmatian
- 930-2335m - Middle Sarmatian
- 2335-2650m - Upper Eocene

A 339mm conductor was run to 317m. The 317-2650m interval was drilled with 215mm bit. This is the first time that the Sarmatian and the Upper Eocene were drilled and cased together in Ninotsminda. This eliminated the need for the 9 5/8"

intermediate string over the Sarmatian interval. This is estimated to have saved about 0.4 MM \$US in drilling costs. Currently the well is cased with 7" casing near the Middle Eocene top.

3.2.1 N98 FUTURE OPERATIONS:

The Middle Eocene will be drilled with a 151mm bit and cased with a 127mm liner. Initial production of 650 bopd is expected in November.

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3.3 WELL N97

Rigging up of well #97 is 95% complete. The well is planned to be spudded in November 1998, south east of N21 (Figure 2). The well will be allowed to drift naturally to the south while drilling to the top of the Middle Eocene. A 400 m horizontal section, 40 meters below the GOC in the south west direction is planned. The well will be completed with a slotted liner, and put on production in March. Initial production is expected to be 850 bopd.

3.4 WELL N99

N99 is planned to be drilled 1550m east of N52 after the drilling of well N97 is complete. The well will penetrate the Middle Eocene as a horizontal well. A 300 m oil column is expected and the OWC is expected to be 2000 mss. Expected spud date is second quarter of 1999. Expected initial production is 850 bopd.

This well is to be drilled as a horizontal well, with the flexibility in the casing design to allow for lateral extensions.

3.5 WELL N100

N100 is planned to be drilled 2500m east of N52 as a horizontal well to the Middle Eocene. This well is in the east of the reservoir. A 170 m oil column is expected and the OWC is expected to be at 2020 mss. This well will be spudded based on the results of N105 and N99. Expected spud date is the third quarter of 1999, and expected initial production is 850 bopd.

Like N99, this well is to be drilled as a horizontal well, with the flexibility in the casing design to allow for lateral extensions.

3.6 WELL N105

N105 will be drilled after N98 and from the same location. NOC plans to skid the drilling unit over 20 m. This will save mobilization time and will utilize existing infrastructure. The well will be directionally drilled to the north east from N98 (surface location) and penetrate the top of the Middle Eocene approximately 300-500 m east of N98 (Middle Eocene top). The horizontal section will be 500-800 meters long on a 55 degree azimuth. A 400 m oil column is expected with an OWC estimated to be at 1980 mss. Expected initial production is 850 bopd.

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3.7 DRILLING SUMMARY

<TABLE>

<CAPTION>

| WELL NO. CONSTANT RATE | SPUD DATE | COMPLETION DATE | COST \$US | INITIAL RATE bopd | UPSIDE RATE bopd | |
|---------------------------|-----------|-----------------|-----------|----------------------|---------------------|-----|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| N97 | Nov-98 | Mar-99 | 3.0 | 850 | 1,400 | |
| 2 | | | | | | |
| N98 | Aug-98 | Nov 98 | 2.5 | 650 | 750 | |
| 2 | | | | | | |
| N99 | May-99 | Sept-99 | 2.5 | 850 | 1,300 | |
| 2 | | | | | | |
| N100 | Sep-99 | Dec-99 | 2.5 | 850 | 1,300 | |
| 2 | | | | | | |
| N105 | Jan-99 | May-99 | 2.5 | 850 | 1,400 | |
| 2 | | | | | | |
| TOTAL | | | 13.0 | 4,050 | 6,150 | |

</TABLE>

TABLE 5 DRILLING SUMMARY

4 WORKOVER PROGRAM

There are currently 6 producing wells in Ninotsminda field. For 1998 and 1999, 5 major workover operations as a minimum have been planned which will increase the number of producing wells from 6 to 11. A major workover is defined to be a stimulation technique with a minimum AFE amount of \$US 50,000 and/or a recompletion.

<TABLE>

<CAPTION>

| WELL NO. RIG | TASK 1 bbl/\$ | TASK 2 | EST. COST M \$US | CURRENT PROD bopd | EST. POST WO bopd |
|-----------------|------------------------|------------------|---------------------|----------------------|----------------------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| <C> | <C> | | | | |
| N30 FTN | Isolate Gas 4.91 | Perf, Acid & Oil | 56 | 75 | 350 |
| | | Squeeze * | | | |
| N96 A50 | Isolate Water 3.33 | Add Perfs | 60 | 200 | 400 |
| N22 FTN | Selective Acid 2.81 | Oil Squeeze | 80 | 150 | 375 |
| N32 FTN | Fish 2.14 | Clean out | 105 | 0 | 225 |
| N59 FTN | Clean Out 2.08 | | 72 | 0 | 150 |
| TOTAL | | | 373 | 425 | 1,500 |

</TABLE>

TABLE 6 WORKOVER PROPOSAL SUMMARY

*This second operation will be performed if required.

NOC investigated all possible WO's (11) that could be done in Ninotsminda and Rustavi fields. These workovers ranged from fishing and cleanouts, to isolating water, perforating, isolating gas, drilling cement, and hydraulic fracturing. The workovers are all summarized in Appendix One.

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These workovers were then prioritized for operations based on the highest barrel received for workover \$ spent. NOC's aim was to determine which wells should be worked over to ensure that by the end of 1999, there would be 4,500 bopd of production. The production from the field and newly drilled wells was estimated to be 3,600 bopd in Dec 1999. This implies that NOC requires 900 bopd for the end of 1999 from workover operations.

Table 6 shows the five wells chosen for workovers based on the greatest barrel/\$. The incremental increase in production from these workovers is estimated to be 1,075 bopd. Taking into account decline and providing a little insurance resulted in 5 wells chosen for a minimal workover program. The following Table 7 shows the conservative production estimated for Dec 1999.

<TABLE>

<CAPTION>

| NEW WELLS 1999 | INITIAL BOPD | DECLINE % | DECLINE bopd | bopd DEC |
|-------------------|--------------------|-----------|--------------|----------|
| ----- | ----- | ----- | ----- | ----- |
| <S> | <C> | <C> | <C> | <C> |
| Current Prod | 1,500 | 25 | 375 | 1,125 |
| N98 | 650 | 15 | 98 | 553 |
| N97 | 850 | 10 | 85 | 765 |
| N105 | 850 | 10 | 85 | 765 |
| N99 | 850 | 0 | | 850 |
| N100 | First oil Jan 2000 | | | |
| SUB TOTAL | 4,700 | | | 4,058 |
| NEW WORKOVERS | | | | |
| N30 | 275 | 30 | 83 | 193 |
| N96 | 200 | 25 | 50 | 150 |
| N22 | 225 | 20 | 45 | 180 |
| N59 | 150 | 20 | 30 | 120 |
| N32 | 225 | 10 | 23 | 203 |
| SUB TOTAL | 1,075 | | | 845 |
| All Wells | | | | |
| Old and New | 4,400 | | | 4,058 |
| Workovers | 1,075 | | | 845 |
| TOTAL DEC 1999 | | | | 4,903 |

</TABLE>

TABLE 7 CONSERVATIVE ESTIMATE OF DEC 1999 PRODUCTION VOLUMES

It should be noted that the fishing, drilling of cement, and fracturing would require a more powerful workover rig than the A50 rig, which is currently being used. A small portable Fountain drilling rig will be utilized to perform the heavier operations that require greater pulling and drilling capabilities than the A50 has. This "Fountain" rig is expected to be in Georgia by the end of November, be tested in December and operational in January.

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Figure 3 is a Gant diagram detailing the time line for the workovers. Appendix One contains the details for each proposed workover.

5 OTHER REQUIREMENTS

Due to the expansion of drilling and production activities, the following additional operations and equipment are required for the Ninotsminda field:

5.1 BASE EXPANSION:

Require facilities to shelter the chemical and mud purchases and store the casing and tubing. Unloading facilities such as pipe racks are envisioned. NOC currently does not have enough sheltered facilities to store the chemicals for one well. The estimated cost for these facilities is \$US 50,000.

5.2 PURCHASE OF ADDITIONAL PRESSURE TRANSIENT EQUIPMENT.

Currently NOC hangs the pressure gauges on wireline during the pressure testing. For the buildup portion of the test the flowlines are shut-in. This results in wellbore storage effects that mask the data. Attempts at type curve matching the resulting transient curves have proven less accurate than desired. It is recommended that 2 "R" nipples and a perforated pup are run in each well, and that the proper wireline tools to land the pressure gauges and plugs are purchased. This will allow NOC to land the gauges in the lower "R" nipple for the flow tests and then set a plug in the upper "R" nipple for the build up portion of the test. The resulting data will have less storage effects and therefore more usable data. The cost is estimated to be \$US 20,000.

5.3 PVT TESTING

A PVT analysis is required to determine important reservoir fluid properties used in predicting field performance and to determine if the gas cap is a primary or secondary gas cap. Cost for this analysis is estimated to be \$US 30,000.

5.4 TWO WATER SUPPLY WELLS

Two water supply wells are required to supply the drilling rigs with water during drilling. GBOC currently pays \$US 5,000 per month to deliver water to the drilling rigs. It is expected that each water supply well will cost \$US 5,000 and provide 100 m3/d water to the rigs and save the company \$US 50,000.

5.5 PRODUCTION FACILITY UPGRADES

An oil pumping unit is required to pump the production from well N100 to the Ninotsminda facilities. Storage and flaring facilities will be required in case of electrical supply failures. Estimated costs are \$US 25,000.

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5.6 ACCOMMODATION

Additional facilities for board and lodging are required. Today's capacity is for one drilling crew, but with the second rig, GBOC will require a second crew's quarters. Delivery and purchase cost is estimated to be \$US 50,000.

5.7 TRANSPORTATION

3 Chevy vehicles coming with the Fountain rigs will be purchased. These are estimated to cost \$US 75,000 and will replace old vehicles.

5.8 COMMUNICATION / COMPUTERS

Additional communications equipment is required. This includes 5 additional

computers, 2 printers, 1 plotter and improved Internet connection (either cable or wireless). Estimated costs are \$US 20,000.

5.9 EDUCATION

Education is required to train accountants in the corporate accounting policy and engineers in technical courses such as multi lateral and horizontal drilling. Estimated costs are \$US 32,000.

6 PAST AND PLANNED EXPENDITURES

The following Table 8 summarises the expenditures for 1998 and 1999.

<TABLE>

<CAPTION>

| | ITEM | 1998 \$US M | 1999 \$US M | TOTAL \$US M |
|-----|------------------------------------|-------------|-------------|--------------|
| | ---- | ----- | ----- | ----- |
| <S> | | <C> | <C> | <C> |
| | Seismic | 247 | 30 | 277 |
| | Major Workovers | 257 | 373 | 630 |
| | Development Wells | 5,198 | 7,700 | 12,898 |
| | Facilities | 1,307 | 312 | 1,619 |
| | SUB-TOTAL | 7,009 | 8,415 | 15,424 |
| | Working Capital and Interest Costs | 1,100 | 500 | 1,600 |
| | Georgian Oil Asset Purchase | 348 | 176 | 524 |
| | IFC Financing Costs | 500 | | 500 |
| | Contingencies | | 900 | 900 |
| | TOTAL | 8,957 | 9,991 | 18,948 |

</TABLE>

TABLE 8 PAST AND PLANNED EXPENDITURES SUMMARY 1998 & 1999

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7 FULL FIELD DEVELOPMENT; INTO THE NEW MILLENIUM

7.1 RESERVES

According to estimates from AMH, proven plus probable reserves in Ninotsminda are 52 mmbo. NOC has 52 mmbo as the basis for the following Full Field Development plan.

7.2 DRAINAGE AREAS

To evaluate a future development plan required an estimate of the drainage areas and shapes to expect with this project. Drainage shapes will be dependent upon the macrofracturing experienced in this reservoir. The macrofracturing observed appears to be in both, a north south and in an east west trend. Production trends and pressure analysis results indicate that the faults are intersecting. This implies that the drainage will be in a square shape for a vertical well. For a horizontal or lateral well, the toe of the wellbore will not have as wide a width as the heel of the wellbore due to the pressure drop along the wellbore.

A volumetric calculation was done that compared the volume produced to an equivalent drainage area for each well in the Samgori and Patardzeuli Fields. It was assumed that these reservoirs were essentially drained. It appears that the wells were draining squares areas of 600-800 m length in the early stages and the later infill wells drained areas of around 200 m lengths. Some infill wells even though drilled on the crest did not produce more than 30,000 m3 because they were too close to a neighbouring good well. N96 appears to be affected by

the neighbouring wells and the spacing there is 450 m or so. This implies that we can expect blocks on the order of 500 meters or so.

See Figure 4 for an estimate of the drainage areas for vertical, horizontal and lateral wells.

7.3 DRILLING

Full field development assumes that horizontal and laterals will be used to drain the reservoir. Once N97, N105, N99 and N100 are completed, there should be enough technology and experience to complete the development of the field using horizontal and lateral well technology. In total, 31 drainage points are needed. These drainage points will include both old and new wells.

To complete the development of the Ninotsminda Reservoir, 15 additional drainage points are required. This can be achieved with the drilling of laterals from 4 wells. Figure 5 illustrates the down hole drainage areas. The horizontals will provide an extended drainage area as compared to the vertical well. A single lateral is the equivalent of a horizontal. If two or more laterals are drilled from a single wellbore, then each lateral will drain a smaller area as compared to a horizontal because of overlap at the heel of the lateral. However for the purposes of this analysis, it was assumed that the lateral would drain the same area as the horizontal and have equivalent production rates. Estimated production rates are 850 bopd.

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Four additional wells over the "Minimum Work Program" will be required. Two of these wells will be horizontal, and two will be lateral. The plan will utilise N99 and N100 for lateral wells. Two other locations will also be drilled for lateral well development, N106 and N107. Together, these four wells will drain a total of 11 horizontal well equivalents.

Two additional wells, N108 and N109, will be drilled horizontally to drain the areas east and west of N21.

"Base wells" (the initial wellbore of a multilateral well) are estimated to cost \$US 2.5 mm to drill to the top of the Middle Eocene and then \$US 0.3 mm for each lateral. Since the mobilisation cost is reduced, NOC expects that several laterals per well will be cheaper than one horizontal extension. The horizontal extension is expected to cost \$US 0.5 mm and the cost for a lateral is \$US 0.3 mm. Thus the cost for a three well lateral is estimated to be \$US 3.4 mm, for a four well lateral, \$US 3.7 mm and for a horizontal \$US 3.0 mm. The drilling is expected to be done continuously into the year 2001.

7.4 WORKOVERS

As described earlier, there is the potential for a total of 12 workover in the Ninotsminda operations. These workovers are described in Appendix One. In addition to the "Minimum Work Program" workovers, there are hydraulic fracture stimulations (N21 and N53), deepening operations (N9), recompletions (N30 and N22) and testing in the West Rustavi field (R16 and R51).

The workovers will increase production, and essentially, will maintain field productivity. These workovers on average will cost \$US 120,000 each. See Appendix One for further workover details.

7.5 FACILITIES

The current facilities in Ninotsminda are capable of handling 17,000 bopd

expected in 2001 and therefore no further facilities are required. Field headers, additional pumps, test units and storage at satellites are envisioned and estimated to cost \$300,000.

7.6 PRODUCTION

Given the above development scenario, the field will produce at a peak rate of about 17,000 bopd in 2001 and produce 50 mmbo over the 19 year project life. Figures 5,6 and 7 illustrate the well build up, daily production and annual production schedules to the year 2016.

7.7 FULL FIELD DEVELOPMENT SUMMARY

The following table shows the Full Field Development and the Minimum Work Program costs. Note that the total cost for the Full Field Development includes the costs associated with the Minimum Work Program.

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<TABLE>

<CAPTION>

| | | |
|--------------------------------|-----------------------|------|
| MINIMUM WORK PROGRAM CAP COSTS | See Above for details | 17.4 |
|--------------------------------|-----------------------|------|

- - - - -

- - - - -

| | | | |
|-----|-----|-----|-----|
| <S> | <C> | <C> | <C> |
|-----|-----|-----|-----|

FULL FIELD DEV. CAPITAL COSTS

| | | |
|---------------|-------|------|
| Seismic Wells | 30 km | 0.28 |
|---------------|-------|------|

| | | | |
|----------|---|---------------|------|
| Vertical | 1 | @ \$US 2.5 mm | 2.50 |
|----------|---|---------------|------|

| | | | |
|------------|---|---------------|-------|
| Horizontal | 4 | @ \$US 3.0 mm | 12.00 |
|------------|---|---------------|-------|

| | | | |
|------------|---|---------------|-------|
| Base Wells | 4 | @ \$US 2.5 mm | 10.00 |
|------------|---|---------------|-------|

| | | | |
|----------|----|---------------|------|
| Laterals | 15 | @ \$US 0.3 mm | 4.50 |
|----------|----|---------------|------|

| | | | |
|-----------|----|--|------|
| Workovers | 12 | | 1.40 |
|-----------|----|--|------|

| | | | |
|----------------------|--|--|------|
| Facilities/Equipment | | | 2.09 |
|----------------------|--|--|------|

| | | | |
|------------------|--|--|------|
| Studies/training | | | 0.50 |
|------------------|--|--|------|

| | | | |
|---------------|--|--|------|
| Miscellaneous | | | 1.73 |
|---------------|--|--|------|

| | | | |
|-----------------|--|--|-------|
| TOTAL \$US mm * | | | 35.00 |
|-----------------|--|--|-------|

</TABLE>

TABLE 9 FULL FIELD DEVELOPMENT SUMMARY

*Full field development will cost \$US 35 mm plus working capital.

8 BRIEFLY ON EXPLORATION POTENTIAL

8.1 MANAVI

This Middle Eocene structure (Figure 9) is located on trend with and east of the Ninotsminda structure. Seismic and geological interpretation indicates 2 domes in the Middle Eocene. The length of the structure is 13.5 km, the width is 3.3 km and the height is 300m. The depth of the structure is 3,700 to 4,000 m. No wells have penetrated the structure. Structures on trend have successfully produced oil from this interval.

Other potential reservoirs include the Upper-Cretaceous Paleocene, Lower Eocene and Upper Eocene. Gas has been tested in Teleti and Varketili at rates up to 7-10 mmcf/d in the Upper-Cretaceous Paleocene interval. The Lower Eocene has produced gas at 1-3 mmcf/d in Samgori and the Upper Eocene has produced oil at rates of up to 160 m³/d in Ninotsminda and Patardzeuli.

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Middle Eocene recoverable reserves have been estimated to be 68-83 mmbo. Upper Cretaceous Paleocene recoverable gas reserves have been estimated to be 667 BCF.

8.2 WEST RUSTAVI AND NINOTSMINDA

As with Manavi, there is the potential for Upper-Cretaceous Paleocene and Lower Eocene production (Figure 9).

The Upper Cretaceous Paleocene gas potential is 440 BCF.

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9 APPENDIX 1 DETAILED WORKOVER PLAN

9.1 N9

A cement plug is set at 2564m (1668 mss). The perforated interval is 2564-2536m (1640-1668 mss). Significant gas flow was obtained from the well. Presumably the gas was channeling behind the 114mm-liner annulus.

Based on well data (N16) and from log analysis, it appears that the gas cap on the Ninotsminda field is at 1550-1578 mss. For our calculations we used the figure 1600 mss. The interval 2693-2640m (1703-1650mss) is perforated in N4, and the interval 2614-2578m (1681-1647mss) is perforated in N46. Both of these wells are currently producing pure oil with minor gas.

Since N9 is perforated at the same subsea depth as N4 and N46, it appears then that N9 is perforated well below the GOC and that the gas seen was channeling behind a poorly cemented liner.

It should be noted, that N9 upon initial completion produced pure gas from 2754-2800m (1858-1904mss) interval. This is another indication that the annulus was not cemented properly. After successful isolation of gas zone the well produced 897,000 bbl of oil.

Workover operations are aimed at isolation of the gas zone and perforation of new interval. Since the operation will require drilling out of the cement within the liner, the use of the Fountain rig is required. The costs are estimated to be \$US 130,000. Expected rate is 250 bopd.

9.2 N21

The Middle Eocene is penetrated at 2,740-2,961 mss. The GOC is at 2,732 m. Cumulative oil production during 1984 to 1998 was 11,000 bbl. The reasons for low production rate are as follows:

1. The main fractured reservoir unit was damaged by cement and heavy mud while drilling
2. Technical conditions of the well: the top of the Middle Eocene has two casings 127mm and 89mm casings.
3. 89mm casing is damaged at 2838m depth and tools can not be run below

that depth

4. An attempted acid treatment was complicated by high treatment pressures and the large treatment interval. As a result the treatments proved unsuccessful.

To obtain production, the 73mm and 60mm tubing will be changed to 89mm tubing, a sand plug will be set over the lower perforations, the remaining perfs are to be reperforated and then a 7 tonne hydraulic frac stimulation will be performed. The expected rate is 150 bopd. Estimated costs are \$US 260,000.

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9.3 N22

The following 3 intervals are perforated in the well: 3085-3080m, 2935-2840m and 2840-2798m. According to production tests the majority of the oil is produced from the old perforated intervals (2925-2920m and 2868-2886m). It appears that the acid and oil squeeze treatments treated the highly permeable, drained macro-fractured intervals. In order to operate all perforated intervals, a selective treatment of the formation is required.

Expected rate is 375 bopd. The estimated cost is \$US 80,000.

9.4 N30

A cement plug is set at 2582m (1662mss). The perforated interval is at 2570-2582m (1662-1650mss). In the past, 750 to 1000 bopd and a significant amount of gas were produced. The well is perforated the same highly productive intervals and at similar depths when compared to N46 and N4, both of which produce oil without gas. It appears that the gas is channeling behind the 114mm-liner head.

The isolation of the gas channel by a cement plug or packer is required. It is proposed to try setting a packer first with the A50 rig. If unsuccessful a cementing operation and drilling out of the cement with the Fountain rig will be required. New perforations, from 2582 to 2570 m will be shot, followed by acid and oil squeezing. The expected cost is \$US 56,000 if the Fountain Rig is used. The expected rate is 350 bopd.

9.5 N32

A cement plug is set at 2724m, and the interval 2724-2658m (1703-1637mss) is perforated. The well initially produced 65 bopd. Two acid jobs and 4 oil squeezes without sand were tried to improve well productivity. Production was 35 bopd when one oil squeeze with sand was tried. Sand or formation fines fell on top of the packer and stuck the packer in the hole. This prevented cleaning the 25m of sand that is over the perfs.

It is required to fish the tubing and packer. This can be done in several different ways, either by utilizing left hand drill pipe to back off the tubing, right hand drill pipe with a tool to reverse downhole rotation again to back off the tubing, back off utilizing strip charges or mechanical cutters. Once the tubing is removed, the fill can be removed and the packer released. Once the packer is removed, the fill can be washed out and the oil squeeze with sand can be evaluated.

An alternative is being considered whereby the sand will be washed out by utilizing a coiled tubing unit. This means though that the stuck tubing and packer will still be in the hole.

Once the sand plug is removed, the expected rate is 225 bopd. The estimated cost to remove the stuck tubing by utilizing the left-hand drill pipe and backoff is \$US 105,000.

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Ninotsminda Oil Company

Wednesday, February 10, 1999

Updated Field Development Plan

9.6 N49

In May 1996, a cement plug was set at 2895m. The well was perforated over the 2870 to 2774m (1749-1653 mss) interval. The well has produced 436 mbbbl of oil since May 1996. Recently, the water cut has increased to 25%, which could be caused either by deterioration of the cement plug or by water coning.

It is required to check for the cement plug, identify the source of the water and then isolate the water zone. Once done, the potential exists to add 24 m of additional pay in this well. Adding additional pay is expected to increase the current production by 25% from 350 to 450 bopd. The estimated cost to do this is \$US 51,000.

9.7 N53

A cement plug is set at 3013m and the perforations are at 2944-2712m. In spite of multiple attempts including gas lift, NOC has not achieved a constant oil flow from the well.

Selective treatment of the oil interval 2850-2910m is required. If the operations on N21 prove successful a hydraulic fracture stimulation will be attempted. The expected production is 150 bopd.

The estimated cost is \$US 160,000. This cost is less than that of N21 because the purchase of tubing and reperforating will not be required.

9.8 N59

The well has produced 163,000 bbl oil over the 2691-2675m interval at the following rates:

| | |
|------------|---------------|
| 5mm choke | - 55m(3)/day |
| 6mm choke | - 96m(3)/day |
| 10mm choke | - 140m(3)/day |

The well was put into production in 1986, but a sand plug was formed after one year and blocked production. The sand plug is estimated to be at 2540m depth. The tubing is stuck and appears to be damaged at about 1000m.

It is required to clean out the sand plug, pull and replace the damaged tubing and add new perforations over the intervals 2675-2665m and 2615-2623m. The expected rate of production is 150 bopd. The estimated cost for this workover is \$72,000.

Potential exists for hydraulic fracture stimulating this interval as well. To evaluate this potential, a production and build up test will be performed on N2 to determine the extent of damage and the potential for further evaluation.

9.9 N96

N96 was TD'ed in August 1997, at 2731m (1731mss). The following casing is in the hole:

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Wednesday, February 10, 1999

| | |
|--------------------|--------------|
| 508mm conductor | - 209m |
| 340mm tech. casing | - 1820m |
| 245mm tech. casing | - 1408m |
| 178mm liner | - 2307-2647m |
| Open hole | - 2647-2731m |

There is a fish (a Geophysica production tool) at 2715m. In December 1997, during the last attempt at cleaning out the well, the tubing could not be lowered below 2675m. Hole sloughing was observed then at the 2675-2715m interval as evidenced by the coarse rocks that were recovered when attempting to circulate the well clean.

Cumulative oil production is 156,800 bbl. Production was initially 750 bopd but has since dropped to 200 bopd with a corresponding increase in water cut from 10% to 40%.

It is required to identify and then isolate the source of the water production. Water could be coming up through the fill in the wellbore or up through the natural fracture. A cement plug over the bottom of the wellbore may be required to isolate the water production.

There is the potential to add 51 meters of additional pay over the interval 2647-2698m. If done the expected rate is 400 bopd. The expected cost to log the well, set a plug and add perforations is \$60,000.

An alternative to using the A50 is being evaluated. The coiled tubing unit could set the cement more accurately than the aggregates and reduce the risk of the cement being displaced into the natural fracture.

9.10 R16

In December 1997, a cement plug was set at 2184m. Perforations were shot over the interval 2181-2114m. Oil and water flow from the well is 100 bpd. The current water cut is 75%.

The source of the water must be determined and then isolated by a cement plug. As with N96 logs thermodebitometer and temperature logs will need to be run to identify the water zone. A cement plug will then be set to isolate the water production. The expected oil rate is 80 bopd and is expected to cost \$US 30,000.

9.11 R51

178mm production casing is run to 2055m and the well is perforated over the interval 2047-2018m. The well produces oil periodically in the past but is now shut in. This well is updip of well R16 and will be required to increase our understanding of the West Rustavi field for future development.

The well will be perforated over the interval 2018-1970m. 75 bopd is expected from this operation. The estimated cost is \$US 70,000.

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Wednesday, February 10, 1999

9.12 WORKOVER SUMMARY

<TABLE>
<CAPTION>

| WELL NO. RIG | TASK 1 bbl/\$ | TASK 2 | EST. COST m \$US | CURRENT PROD bopd | EST. POST WO bopd |
|-----------------|------------------|------------------|---------------------|----------------------|----------------------|
| <S> | <C> | <C> | <C> | <C> | <C> |
| N9 | Isolate Gas | New Perfs | 130 | 0 | 250 |
| FTN | 1.92 | | | | |
| N21 | Hydraulic Frac | | 260 | 0 | 150 |
| A50 | 0.58 | | | | |
| N22 | Selective Acid | Oil Squeeze | 80 | 150 | 375 |
| FTN | 2.81 | | | | |
| N30 | Isolate Gas | Perf, Acid & Oil | 56 | 75 | 350 |
| FTN | 4.91 | | | | |
| | | Squeeze * | | | |
| N32 | Fish | Clean out | 105 | 0 | 225 |
| FTN | 2.14 | | | | |
| N49 | Isolate Water | | 51 | 350 | 450 |
| A50 | 1.96 | | | | |
| N53 | Hydraulic Frac | | 160 | 1 | 150 |
| A50 | 0.94 | | | | |
| N59 | Clean Out | | 72 | 0 | 150 |
| FTN | 2.08 | | | | |
| N96 | Isolate Water | Add Perfs | 60 | 200 | 400 |
| A50 | 3.33 | | | | |
| R16 | Clean Out | Add Perfs | 30 | 25 | 80 |
| A50 | 1.83 | | | | |
| R51 | Clean Out | Add Perfs | 70 | 0 | 75 |
| A50 | 1.07 | | | | |
| TOTAL | | | 1,074 | 801 | 3,055 |

</TABLE>

TABLE 1-1 WORKOVER SUMMARY

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10 APPENDIX 2 PAST AND PLANNED EXPENDITURES 1998 TO 1999

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SCHEDULE 10

Minimum Work Program

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NINOTSMINDA OIL COMPANY LIMITED
1580, 727 - SEVENTH AVENUE S.W.,
CALGARY, ALBERTA T2P 0Z5

TELEPHONE : (403) 777-1185
FACSIMILE : (403) 777-1578

October, 1998

MINIMUM WORK PROGRAM

The Minimum Work Program is a program of work commencing on January 1, 1998. The Minimum Work Program will consist of and will be satisfied upon completion of the milestones defined below. The performance of the Minimum Work Program will be guided in principle by good oilfield, engineering practices and the Updated Field Development Plan submitted separately to the IFC. The Updated Field Development Plan includes the proposed plans for 1998/1999 and will serve as the template to meet the IFC requirements. The Updated Field Development Plan will be revised from time to time based on results and good engineering practices.

- 1) Drill and test five wells, in the Ninotsminda field, for hydrocarbon potential.
- 2) Perform a minimum of eight major workovers on existing wells in the Ninotsminda/West Rustavi fields. A major workover is defined to be a stimulation technique with a minimum AFE amount of \$50,000 and/or recompletion.
- 3) On a continuous basis, perform minor workovers and other field maintenance activities designed to maintain field production levels as required by good oilfield practice.
- 4) Acquire and process approximately 30 km of seismic in the Ninotsminda and West Rustavi fields. Re-process such additional readily available seismic data that is considered useful on the Ninotsminda and West Rustavi fields. Perform interpretation of available data with the objective of refining and improving the proposed plans of the Updated Field Development Plan.
- 5) Purchase, upgrade and maintain field facilities and equipment as required to support the development, production and sale of oil from the Ninotsminda and West Rustavi fields under the Minimum Work Program. Equipment and facilities will be upgraded and maintained with the objective of meeting safe operating conditions and the company's environmental policy.

</TEXT>

</DOCUMENT>

<DOCUMENT>

<TYPE>EX-10.19

<SEQUENCE>4

<DESCRIPTION>PUT OPTION AGREEMENT BETWEEN CANARGO ENERGY

<TEXT>

<PAGE> 1

EXHIBIT 10(19)

CONFORMED COPY

INVESTMENT NUMBER 8138

=====

PUT OPTION AGREEMENT

BETWEEN

CANARGO ENERGY CORPORATION

AND

JKX OIL & GAS PLC.

AND

INTERNATIONAL FINANCE CORPORATION

DATED DECEMBER 17, 1998

=====

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PUT OPTION AGREEMENT

AGREEMENT dated December 17, 1998, between CanArgo Energy Corporation, a Delaware corporation ("CanArgo"), JKX Oil & Gas plc., a company registered in England ("JKX") and International Finance Corporation, an international organization established by Articles of Agreement among its member countries (hereinafter called "IFC").

WHEREAS:

- (A) By a convertible loan agreement (the "Convertible Loan Agreement") dated as of even date herewith between IFC and Ninotsminda Oil Company (the "Company"), IFC has agreed to extend to the Company a convertible loan (the "Loan") in the principal amount of six million Dollars (\$6,000,000), on the terms and subject to the conditions set forth in the Convertible Loan Agreement.
- (B) By virtue of Section 6.01 (d) of the Convertible Loan Agreement, it is a condition of the initial disbursement of the Loan that CanArgo and JKX enter into a Put Option Agreement with IFC pursuant to which IFC shall have the right following conversion of the Loan, to put any of its shares in the Company to CanArgo and JKX, on several basis as more fully set forth below.

NOW, THEREFORE, the parties agree as follows:

ARTICLE I

DEFINITIONS

Section 1.01. Wherever used in this Agreement, unless the context otherwise requires or unless otherwise defined herein, terms defined in the Convertible Loan Agreement have the same meanings herein.

Section 1.02. Wherever used in this Agreement, unless the context otherwise requires, the following terms shall have the following meanings:

"Compounded Dollar Cost" the aggregate amount of Dollars at any time or from time to time disbursed by IFC for the purpose of paying for IFC Shares plus the Dollar equivalent value of any

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taxes, fees or other charges in connection with the purchase or subscription of IFC Shares, compounded semi-annually at the rate of twelve percent (12%) per annum from the Conversion Settlement Date to the relevant Put Settlement Date (provided that such compounding rate shall, for any period less than six months, be prorated on the basis of a 360-day year and the actual number of days elapsed).

"Compounded Dollar Dividends" the amount of Dollars (if any) at any time or from time to time received by IFC in immediately available funds in New York City, New York, United States of America, as the proceeds of conversion of cash dividends paid on or with respect to the IFC Shares, compounded semi-annually at the rate of twelve percent (12%) per annum from the date or dates of receipt by IFC to the relevant Put Settlement Date (provided that such compounding rate shall, for any period less than six months, be prorated on the basis of a 360-day year and the actual number of days elapsed).

"Compounded Dollar Sales Proceeds" the aggregate of (i) in the case of any sale of IFC Shares pursuant to this Agreement, the actual amount of Dollars received by IFC in immediately available funds in New York City, New York, United States of America, as the proceeds of such sale; and (ii) in the case of any other sale of IFC Shares, the amount of Dollars that IFC would have received in immediately available funds in New York City, New York, United States of America, as the proceeds of such sale (or the proceeds of conversion into Dollars of the sale proceeds if such other sale was denominated in other currencies), on the same date or dates as Dollars were received under such other sale, if such other sale had instead been made by IFC to CanArgo and JKC pursuant to the

provisions of this Agreement, such amounts in each case compounded semi-annually at the rate of twelve percent (12%) per annum from the date or dates of receipt by IFC to the relevant Put Settlement Date (provided that such compounding rate shall, for any period less than six months, be prorated on the basis of a 360-day year and the actual number of days elapsed).

"Net Asset Value"

the net present value of future Net Cash Flows to NOC, discounted at the Discount Rate, of all probable reserves (risked at 50%) and all proven reserves, plus current assets, plus non Exploration and Production Fixed Assets, less liabilities excluding related party debt (other than amounts paid in accordance with section 7.02(x) and (y) of the Convertible Loan Agreement), the calculation of Net Cash Flows being based on the latest valuation submitted to a recognized securities exchange, or an equivalent independent valuation to be obtained at IFC's option.

"Net Asset Value per Share"

Net Asset Value divided by the sum of the total number of authorized and outstanding shares of the Company plus all shares the subject of outstanding options or warrants;

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"Net Cash Flow"

for any period, Operating Cash Flow less NOC's proportionate share of Project capital development expenses.

"Operating Cash Flow"

means, for any period, the sum of all proceeds from the sale of NOC's share of oil and gas, less NOC's proportionate share of operating costs, operating overheads, royalties, transportation costs and taxes.

"Option Period"

the period commencing on the second anniversary of the Conversion Settlement Date and ending upon the first to occur of: (i) the date on which the Company's shares are accepted for listing on a stock exchange acceptable to IFC (which acceptance shall not be unreasonably withheld) or (ii) December 31, 2007;

"Option Price"

the greater of (i) (x) the amount (but not less than zero) obtained by subtracting from the Compounded Dollar Cost the sum of (A) the Compounded Dollar Dividends and (B) the Compounded Dollar Sales Proceeds, multiplied by (y) the Put Ratio or (ii) the Net Asset Value per Share multiplied by the number of Option Shares the subject of the Put Notice;

"Option Shares"

the aggregate of:

- (i) all shares of the Company purchased by IFC pursuant to the Conversion Option;
- (ii) all shares of the Company subscribed or acquired by IFC pursuant to the exercise of preemptive rights, options or warrants accruing to IFC in relation to any Option Shares;
- (iii) all shares of the Company received by IFC as a result of stock splits or stock bonuses or stock dividends on any Option Shares; and
- (iv) all shares (of any company) received by IFC in exchange, replacement or substitution of any Option Shares;

"Pro-Rata Share"

means a percentage of the Option Price based on the pro-rata ownership interest in the Company of each of CanArgo Limited, in the case of CanArgo, and JKX Nederlands B.V., in the case of JKX;

"Put Notice"

the notice given by IFC to CanArgo and JKX pursuant to Section 2.02, which shall set forth:

- (i) the number of Option Shares which are the subject of the Put Notice;
- (ii) the Option Price and the basis for its determination;

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- (iii) the Put Settlement Date, such date to be not less than thirty (30) days nor more than sixty (60) days after the date of the Put Notice; and
- (iv) the Settlement Place;

"Put Option"

the option, hereby granted, of IFC to sell to CanArgo and/or JKX on a several basis, at the Option Price all or part of the Option Shares;

"Put Ratio"

the ratio obtained by dividing (i) the number of Option Shares the subject of the Put Notice, by (ii) the total number of Option Shares;

"Put Settlement Date"

the date specified in the Put Notice for making payment for the Option Shares; and

"Settlement Place"

the place for any payments to be made under this Agreement, which shall be made for the account of IFC at Northern Trust International Banking Corporation, New York,

New York (IFC's Account No. 10215220300 CHIPS ID 142255) or at such other bank and account as IFC shall notify the parties.

ARTICLE II

THE PUT OPTION

Section 2.01. IFC shall have the option to sell to CanArgo and JKX, on a several basis, any or all of its Option Shares by exercising its Put Option in accordance with Section 2.02 below, and, upon the exercise by IFC of such Put Option, CanArgo and JKX shall be obligated to pay (subject to Section 2.07 hereof) at the Option Price on the Put Settlement Date at the Settlement Place, for all the Option Shares so sold by IFC.

Section 2.02. The Put Option may be exercised by IFC from time to time during the Option Period (subject to the provision of the preceding Section 2.01) in respect of all or part of the Option Shares, by delivery of a Put Notice within the Option Period.

Section 2.03. Upon receipt of a Put Notice, CanArgo and JKX shall, on the Put Settlement Date and at the Settlement Place, acquire the Option Shares which are the subject of the Put Notice and (subject to Section 2.07 hereof) pay therefor the Option Price.

Section 2.04. Payment for the Option Shares referred to in the Put Notice at the Option Price, shall be made in Dollars in New York, New York in immediately available funds, without deduction whatsoever for any fees, taxes, duties or other charges howsoever called, all of which shall be borne by CanArgo and JKX as applicable.

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Section 2.05. Without prejudice to the remedies available to IFC under this Agreement or otherwise, if CanArgo and JKX shall fail to make payment on or before the Put Settlement Date as specified pursuant to this Agreement, CanArgo and JKX shall pay in Dollars, in respect of such payment due and unpaid, a late payment charge calculated from the Put Settlement Date until all amounts due are paid at the rate of three percent (3%) per annum above the rate which appears on the Dow Jones Markets, Inc. Page in the column headed "USD" as of 11:00 a.m., London time, on the Put Settlement Date for whichever period is closest to the duration of such period; such late payment charge shall accrue from day to day and be prorated on the basis of a 360-day year for the actual number of days in the above mentioned relevant period.

Section 2.06. Without prejudice to any remedies available to IFC under this Agreement or otherwise, and notwithstanding any other provision of this Agreement, in the event that, after IFC shall have delivered a Put Notice during the Option Period to CanArgo and JKX, CanArgo and JKX shall fail to pay in full, as herein provided, for all of the Option Shares included in such Put Notice, IFC, at its sole discretion, shall be free to sell, transfer or otherwise dispose of any or all of such Option Shares, provided, however, that (a) if IFC shall sell or otherwise dispose of all of such Option Shares, CanArgo and JKX shall remain severally obligated to pay to IFC, as an indemnity, the difference between the Option Price, plus any late payment charge due pursuant to Section 2.05, minus an amount equal to the proceeds, if any, from such sale, transfer or disposition by IFC, and (b) if IFC shall sell only a portion of such Option Shares, CanArgo and/or JKX shall remain severally obligated to pay to IFC for the Option Shares included in the Put Notice but which were not sold or

otherwise disposed of by IFC and, in addition, CanArgo and JKX shall remain severally obligated to pay to IFC, as an indemnity, the difference between the Option Price, plus any late payment charge due pursuant to Section 2.05, minus an amount equal to the proceeds, if any, from the sale, transfer or disposition by IFC.

Section 2.07. Notwithstanding any other provision of this Agreement to the contrary, the obligations of CanArgo and JKX to purchase the Option Shares from IFC and to pay to IFC the Option Price therefor (or to indemnify IFC under Section 2.06 in respect of any deficiency between the Option Price and amounts received by IFC following any sale, transfer or disposition in accordance with said Section 2.06) shall be several and not joint, and shall be further limited up to the Pro-Rata Share of each of CanArgo and JKX.

ARTICLE III

SALE TO THIRD PARTIES

Section 3.01. Notwithstanding the provisions of Article II hereof, but subject to Section 3.02 below, nothing in this Agreement shall be deemed to restrict or otherwise affect IFC's right to sell, transfer, assign or otherwise dispose of all or any portion of the Option Shares in its sole discretion.

Section 3.02. If at any time IFC receives from any person or persons an offer to purchase all or any portion of the Option Shares, and if such offer is acceptable to IFC, then IFC shall notify CanArgo and JKX of the terms thereof and each of CanArgo and JKX may (no later than 30 days after receipt of IFC's notice) give IFC an

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irrevocable notice of its election to purchase, on identical terms and conditions, all or such portion of the Option Shares as IFC may wish to sell.

Section 3.03. If at any time CanArgo decides to sell all or a percentage of the shares of the Company held by it (the "CanArgo Shares"), it shall, if IFC so requests, only sell all or some of the CanArgo Shares if the sale also comprises all or the same percentage of IFC's Option Shares, if necessary by reducing the number of CanArgo Shares to be able to sell the required number of Option Shares. CanArgo shall notify IFC of the terms and conditions on which it has decided to sell CanArgo Shares, and IFC shall have sixty (60) days to decide whether it wants to sell any or all of its Option Shares as herein provided.

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ARTICLE IV

REPRESENTATIONS AND WARRANTIES

Section 4.01. Each of CanArgo and JKX hereby separately represents and warrants as to itself only:

(a) that it has the full power, authority and legal right to incur the

obligations provided for in this Agreement, to execute and deliver this Agreement, and to perform and observe the terms and provisions hereof;

(b) this Agreement constitutes its legal, valid and binding obligation, enforceable against it in accordance with the terms thereof;

(c) the execution, delivery and performance of this Agreement have been duly authorized by all necessary action on its part;

(d) the execution, delivery and performance of this Agreement does not violate or exceed its powers or contravene (i) any provision of any applicable law, regulation, decree or order to which it is subject, (ii) any provision of its charter documents, or (iii) any provision of any mortgage, deed, contract, agreement or other instrument to which it is a party, or which is binding upon it or any of its assets; and

(e) all authorizations, consents, approvals and licenses required for the execution, delivery and performance of this Agreement have been duly obtained or granted and are in full force and effect.

ARTICLE V

MISCELLANEOUS PROVISIONS

Section 5.01. IFC shall, on the Put Settlement Date or as soon as practicable thereafter but only after receipt of the Option Price, transfer to CanArgo and JKC as applicable, the certificates representing the Option Shares, free and clear of liens, charges and encumbrances, together with such instruments of transfer, if any, as shall be required by applicable law to effect the transfer.

Section 5.02. CanArgo and JKC shall pay all taxes (including stamp taxes), duties, fees, funds, or other charges levied or imposed by any jurisdiction as may be payable on or in connection with, the execution, issue, delivery, registration, or notarization of this Agreement, and the sale, transfer or delivery of the Options Shares and any documents related thereto, and shall reimburse IFC for any such taxes, duties, fees, funds, or other charges paid by IFC thereon.

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Section 5.03. CanArgo and/or JKC shall pay to IFC, or as IFC may direct, the fees and expenses of IFC's counsel incurred in connection with the exercise by IFC of its rights under the Put Option.

Section 5.04. CanArgo and JKC, in their capacity as the sole owners of the Immediate Shareholders of the Company, undertake to take such action as is necessary so as to prevent any amendment of the charter documents of the Company otherwise than in accordance with the provisions of the Convertible Loan Agreement and the taking of any action by the Company the effect of which would be to restrict or prevent the sale, transfer or disposition of any Option Shares pursuant to this Agreement.

Section 5.05. Any notice or request required or permitted to be given or made hereunder shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand, airmail, facsimile or telex to the party to which it is required or permitted to be given or made at such party's address specified below, or such other address as such party shall have designated by notice to the party giving such notice or making

such request. Any communication to be delivered to any party under this Agreement which is sent by cable, facsimile or telex will constitute written legal evidence between the parties.

For CanArgo:

CanArgo Energy Corporation
P.O. Box 291
Commerce House, Les Banques
St. Peter Port, Guernsey, GY1 3RR
British Isles

Attention: Chairman

Facsimile: 44-1481-729-982

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With a copy sent to:

CanArgo Energy Corporation
Suite 1580, 727 - 7th Avenue S.W.
Calgary, Alberta, Canada
T2P 0Z5

Attention: President

Facsimile: (403) 777-1578

For JKX:

JKX Oil and Gas plc
6 Cavendish Square, London
W1M 9HA, England
United Kingdom

Attention: Chief Executive Officer

Facsimile: 44-171-323-5258

With a copy sent to:

JKX Oil and Gas plc
JKX House, Eastgate Court
High Street, Guildford
Surrey GU1 3DF
England, United Kingdom

Attention: Secretary

Facsimile: 44-1483-242 479

For IFC:

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

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Facsimile: 202-974-4322

Section 5.06. Successors. This Agreement shall bind and inure to the benefit of the respective successors of the parties hereto. Neither CanArgo nor JKX shall assign, delegate or transfer any of their obligations hereunder without the prior written consent of IFC. Any purported assignment in violation of this Section shall be void.

Section 5.07. Jurisdiction and Enforcement. (a) This Agreement is governed by, and shall be construed in accordance with, the laws of the State of New York, United States of America.

(b) Each of CanArgo and JKX irrevocably agrees that any legal action, suit or proceeding arising out of or relating to this Agreement or any other Transaction Document to which they are party may be brought by IFC in the courts of the State of New York or of the United States of America located in the Southern District of New York. Final judgment against CanArgo and JKX in any such action, suit or proceeding shall be conclusive and may be enforced in any other jurisdiction, by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the judgment, or in any other manner provided by law.

(c) By the execution and delivery of this Agreement, CanArgo and JKX irrevocably submit to the non-exclusive jurisdiction of any such court in any such action, suit or proceeding and designate, appoint and empower Corporation Services Company, Two World Trade Center, New York, NY as their authorized agent to receive for and on their behalf service of any summons, complaint or other legal process in any such action, suit or proceeding in the State of New York.

(d) Nothing in this Agreement shall affect the right of IFC to commence legal proceedings or otherwise sue CanArgo and JKX in any other jurisdiction, or concurrently in more than one jurisdiction, or to serve process, pleadings and other legal papers upon CanArgo and JKX in any manner authorized by the laws of any such jurisdiction.

(e) As long as this Agreement remains in force, each of CanArgo and JKX shall maintain a duly appointed agent for the service of summons, complaint and other legal process in New York, New York, United States of America, for purposes of any legal action, suit or proceeding IFC may bring in respect of this Agreement or any other Transaction Document to which they are party. CanArgo and JKX shall keep IFC advised of the identity and location of their respective agent.

(f) Each of CanArgo and JKX also irrevocably consent, if for any reason their authorized agent for service of process of summons, complaint and other legal process in any such action, suit or proceeding is not present in New York, New York, to service of such papers being made out of those courts by mailing copies of the papers by registered United States air mail, postage prepaid, to CanArgo's and JKX's address specified in Section 5.05. In such a case, IFC shall also send by telex or facsimile, or have sent by telex or facsimile, a copy of the papers to CanArgo and JKX.

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(g) Service in the manner provided in subsection (f) above in any such action, suit or proceeding will be deemed personal service, will be accepted by

CanArgo and JKX as such and will be valid and binding upon CanArgo and JKX for all purposes of any such action, suit or proceeding.

(h) Each of CanArgo and JKX irrevocably waives to the fullest extent permitted by applicable law:

(i) any objection which they may have now or in the future to the laying of the venue of any such action, suit or proceeding in any court referred to in this Section;

(ii) any claim that any such action, suit or proceeding has been brought in an inconvenient forum; and

(iii) their right of removal of any matter commenced by IFC in the courts of the State of New York to any court of the United States of America.

(i) To the extent that either CanArgo or JKX may be entitled in any jurisdiction to claim for themselves or their assets immunity in respect of their obligations under this Agreement or any other Transaction Document to which they are party from any suit, execution, attachment (whether provisional or final, in aid of execution, before judgment or otherwise) or other legal process or to the extent that in any jurisdiction such immunity (whether or not claimed) may be attributed to it or its assets, each of CanArgo and JKX irrevocably agrees not to claim and irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction.

(j) Each of CanArgo and JKX hereby acknowledges that IFC shall be entitled under applicable law, including the provisions of the International Organizations Immunities Act, to immunity from a trial by jury in any action, suit or proceeding arising out of or relating to this Agreement or the transactions contemplated hereby or any other Transaction Document to which they are party, brought against IFC in any court of the United States of America. CanArgo and JKX hereby waive any and all rights to demand a trial by jury in any action, suit or proceeding arising out of or relating to this Agreement or any other Transaction Document to which they are party or the transactions contemplated by this Agreement or such Transaction Documents, brought against IFC in any forum in which IFC is not entitled to immunity from a trial by jury.

(k) To the extent that CanArgo and JKX may, in any suit, action or proceeding brought in any of the courts referred to in paragraph (b) above or elsewhere arising out of or in connection with this Agreement or any other Transaction Document to which they are party, be entitled to the benefit of any provision of law requiring IFC in such suit, action or proceeding to post security for the costs of CanArgo and JKX (*cautio judicatum solvi*), or to post a bond or to take similar action, CanArgo and JKX hereby irrevocably waive such benefit, in each case to the fullest extent now or in the future permitted under the laws of the jurisdiction in which such court is located.

Section 5.08. English Language. All documents to be furnished or communications to be given or made under this Agreement shall be in the English language or, if in another language, shall be accompanied by a translation into English certified by a representative of CanArgo and JKX, which translation shall be the governing version between CanArgo, JKX and IFC.

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Section 5.09. Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same agreement.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed as of the date first above written.

CANARGO ENERGY CORPORATION

By: /s/ Michael Binnion
Authorized Representative

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JKX OIL & GAS PLC.

By: /s/ Bruce Burrows
Authorized Representative

INTERNATIONAL FINANCE CORPORATION

By: /s/ Maria da Graca Domingues
Authorized Representative

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EXHIBIT 10(20)

CONFORMED COPY

INVESTMENT NUMBER 8138

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GUARANTEE AGREEMENT

BETWEEN

CANARGO ENERGY CORPORATION

and

INTERNATIONAL FINANCE CORPORATION

DATED DECEMBER 17, 1998

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GUARANTEE AGREEMENT

GUARANTEE AGREEMENT DATED DECEMBER 17, 1998, BETWEEN CANARGO ENERGY CORPORATION (THE "GUARANTOR") AND INTERNATIONAL FINANCE CORPORATION ("IFC").

WHEREAS:

(A) BY A CONVERTIBLE LOAN AGREEMENT (THE "CONVERTIBLE LOAN AGREEMENT") DATED AS OF THE DATE HEREOF, BETWEEN IFC AND NINOTSMINDA OIL COMPANY (THE "COMPANY"), IFC HAS AGREED TO EXTEND TO THE COMPANY A CONVERTIBLE LOAN (THE "LOAN") IN THE PRINCIPAL AMOUNT OF SIX MILLION DOLLARS (\$6,000,000), ON THE TERMS AND SUBJECT TO THE CONDITIONS SET FORTH IN THE CONVERTIBLE LOAN AGREEMENT.

(B) THE GUARANTOR HAS BEEN PROVIDED WITH, AND HEREBY ACKNOWLEDGES RECEIPT OF, A CONFORMED COPY OF THE CONVERTIBLE LOAN AGREEMENT.

(C) BY VIRTUE OF SECTION 6.01(D) OF THE CONVERTIBLE LOAN AGREEMENT, IT IS A CONDITION OF THE INITIAL DISBURSEMENT OF THE LOAN THAT THE GUARANTOR HAS GUARANTEED THE OBLIGATIONS

OF THE COMPANY IN RESPECT OF THE LOAN ON TERMS AND CONDITIONS SATISFACTORY TO IFC.

(D) THE GUARANTOR WILL OBTAIN BENEFITS AS A RESULT OF THE LOAN MADE TO THE COMPANY UNDER THE CONVERTIBLE LOAN AGREEMENT AND, ACCORDINGLY, DESIRES TO EXECUTE AND DELIVER THIS GUARANTEE IN ORDER TO SATISFY THE CONDITION DESCRIBED IN THE PRECEDING PARAGRAPH.

(E) THE GUARANTOR, TO INDUCE IFC TO MAKE THE LOAN AND, IN PARTICULAR, THE FIRST DISBURSEMENT OF THE LOAN, HAS AGREED TO GUARANTEE SUCH OBLIGATIONS OF THE COMPANY.

NOW, THEREFORE, THE PARTIES AGREE AS FOLLOWS:

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ARTICLE I

DEFINITIONS AND INTERPRETATION

SECTION 1.01. DEFINED TERMS. TERMS DEFINED IN THE CONVERTIBLE LOAN AGREEMENT HAVE THE SAME MEANINGS WHEN USED IN THIS GUARANTEE, UNLESS THE CONTEXT OTHERWISE REQUIRES.

SECTION 1.02. GUARANTEED OBLIGATIONS. IN THIS GUARANTEE:

(A) THE TERM "GUARANTEED OBLIGATIONS" MEANS ALL DEBTS AND MONETARY LIABILITIES OF THE COMPANY TO IFC UNDER OR IN RELATION TO THE CONVERTIBLE LOAN AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT AND IN ANY CAPACITY IRRESPECTIVE OF WHETHER THE DEBTS OR LIABILITIES:

(I) ARE PRESENT OR FUTURE;

(II) ARE ACTUAL, PROSPECTIVE, CONTINGENT OR OTHERWISE;

(III) ARE AT ANY TIME ASCERTAINED OR UNASCERTAINED;

(IV) ARE OWED OR INCURRED AS PRINCIPAL, INTEREST, FEES, CHARGES, TAXES, DUTIES OR OTHER IMPOSTS, DAMAGES (WHETHER FOR BREACH OF CONTRACT OR TORT OR INCURRED ON ANY OTHER GROUND), LOSSES, COSTS OR EXPENSES, OR ON ANY OTHER ACCOUNT;

(V) ARE OWED AT STATED MATURITY, UPON PREPAYMENT, FOLLOWING ACCELERATION, OR OTHERWISE, OR

(VI) COMPRISE ANY COMBINATION OF THE ABOVE; AND

(B) THE TERM "THIS GUARANTEE" INCLUDES THE INDEMNITY SET FORTH IN ARTICLE IV.

(C) THE TERM "PRO-RATA SHARE" MEANS A PERCENTAGE OF THE GUARANTEED OBLIGATIONS BASED ON THE GUARANTOR'S PRO-RATA OWNERSHIP INTEREST IN THE COMPANY.

SECTION 1.03. INTERPRETATION IN THIS AGREEMENT, UNLESS THE CONTEXT OTHERWISE REQUIRES:

(A) HEADINGS ARE FOR CONVENIENCE ONLY AND DO NOT AFFECT THE INTERPRETATION OF THIS AGREEMENT;

(B) WORDS IMPORTING THE SINGULAR INCLUDE THE PLURAL AND VICE VERSA;

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(C) AN EXPRESSION IMPORTING A NATURAL PERSON INCLUDES ANY COMPANY, PARTNERSHIP, TRUST, JOINT VENTURE, ASSOCIATION, CORPORATION OR OTHER BODY CORPORATE AND ANY GOVERNMENTAL OR SEMI GOVERNMENTAL AUTHORITY OR AGENCY,

(D) A REFERENCE TO A SECTION, ARTICLE, PARAGRAPH, PARTY, ANNEX, EXHIBIT, OR SCHEDULE IS A REFERENCE TO A SECTION, ARTICLE AND PARAGRAPH OF, AND A PARTY, ANNEX, EXHIBIT AND SCHEDULE TO, THIS AGREEMENT;

(E) A REFERENCE TO A DOCUMENT INCLUDES AN AMENDMENT OR SUPPLEMENT TO, OR REPLACEMENT OR NOVATION OF, THAT DOCUMENT BUT DISREGARDING ANY AMENDMENT, SUPPLEMENT, REPLACEMENT OR NOVATION MADE IN BREACH OF THIS AGREEMENT; AND

(F) A REFERENCE TO A PARTY TO ANY DOCUMENT INCLUDES THAT PARTY'S SUCCESSORS AND PERMITTED ASSIGNS.

ARTICLE II

GUARANTEE

SECTION 2.01. GUARANTEE. THE GUARANTOR IRREVOCABLY, ABSOLUTELY AND UNCONDITIONALLY:

(A) AS PRIMARY OBLIGOR AND NOT MERELY AS SURETY, GUARANTEES TO IFC THE DUE AND PUNCTUAL PAYMENT OF THE GUARANTEED OBLIGATIONS, WHETHER AT STATED MATURITY, UPON PREPAYMENT, FOLLOWING ACCELERATION OR OTHERWISE, AND AGREES TO PAY ANY AND ALL EXPENSES (INCLUDING COUNSEL FEES AND EXPENSES) INCURRED BY IFC IN ENFORCING ANY RIGHTS UNDER THIS GUARANTEE, UP TO AN AMOUNT EQUAL TO ITS PRO-RATA SHARE; AND

(B) UNDERTAKES WITH IFC THAT WHENEVER THE COMPANY DOES NOT PAY ANY AMOUNT OF THE GUARANTEED OBLIGATIONS WHEN DUE THE GUARANTOR WILL, IMMEDIATELY, AND IN ANY EVENT FORTHWITH UPON DEMAND BY IFC, PAY SUCH AMOUNT, UP TO ITS PRO-RATA SHARE, TO IFC, IN THE CURRENCY PRESCRIBED IN THE CONVERTIBLE LOAN AGREEMENT OR THE RELEVANT TRANSACTION DOCUMENT, AND OTHERWISE IN THE SAME MANNER IN ALL RESPECTS AS THE GUARANTEED OBLIGATIONS ARE REQUIRED TO BE PAID BY THE COMPANY.

SECTION 2.02. CONTINUING GUARANTEE. (A) THE GUARANTEE AND THE INDEMNITY CONTAINED IN THIS GUARANTEE IS EACH A CONTINUING OBLIGATION OF THE GUARANTOR, AND SHALL REMAIN IN FULL FORCE AND EFFECT UNTIL THE EARLIER OF:

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(I) THE GUARANTEED OBLIGATIONS HAVE BEEN FULLY PAID STRICTLY IN ACCORDANCE WITH THE PROVISIONS OF THE CONVERTIBLE LOAN AGREEMENT AND THE TRANSACTION DOCUMENTS; OR

(II) THE FINANCIAL COMPLETION DATE.

(B) THE GUARANTEE AND THE INDEMNITY CONTAINED IN THIS GUARANTEE SHALL BE ADDITIONAL, SEPARATE AND INDEPENDENT OBLIGATIONS OF THE GUARANTOR.

(C) THE GUARANTEE AND THE INDEMNITY CONTAINED IN THIS GUARANTEE SHALL SURVIVE THE TERMINATION OF ANY TRANSACTION DOCUMENT.

(D) THE GUARANTOR'S OBLIGATIONS UNDER THIS GUARANTEE CAN BE DISCHARGED ONLY BY PERFORMANCE AND THEN ONLY TO THE EXTENT OF SUCH PERFORMANCE. THE GUARANTOR'S OBLIGATIONS ARE NOT SUBJECT TO, AND THE GUARANTOR HEREBY WAIVES THE REQUIREMENT FOR, ANY PRIOR NOTICE TO, PROTEST, DEMAND UPON OR ACTION AGAINST THE COMPANY, OR ANY PRIOR NOTICE TO THE GUARANTOR WITH REGARD TO ANY DEFAULT BY THE COMPANY.

(E) THIS GUARANTEE SHALL CONTINUE TO BE EFFECTIVE, OR BE REINSTATED, AS THE CASE MAY BE, IF AT ANY TIME ANY PAYMENT OF A GUARANTEED OBLIGATION IS RESCINDED OR MUST OTHERWISE BE RETURNED BY IFC OR ANY OTHER PERSON AS A RESULT OF A COURT ORDER OR OTHERWISE UPON THE INSOLVENCY, BANKRUPTCY OR REORGANIZATION OF ANY PERSON, AS THOUGH SUCH PAYMENT HAD NOT BEEN MADE.

SECTION 2.03. NO SET-OFF. ALL PAYMENTS WHICH THE GUARANTOR IS REQUIRED TO MAKE UNDER THIS GUARANTEE SHALL BE WITHOUT ANY SET-OFF, COUNTERCLAIM OR CONDITION.

SECTION 2.04. TAXES. (A) THE GUARANTOR SHALL PAY OR CAUSE TO BE PAID ALL PRESENT AND FUTURE TAXES, DUTIES, FEES AND OTHER CHARGES OF WHATSOEVER NATURE, IF ANY, NOW OR IN THE FUTURE LEVIED OR IMPOSED BY CANADA OR GEORGIA OR BY ANY AUTHORITY OF EITHER OF THE FOREGOING, OR BY ANY ORGANIZATION OF WHICH EITHER OF THE FOREGOING IS A MEMBER OR ANY JURISDICTION THROUGH OR OUT OF WHICH A PAYMENT IS MADE ON OR IN CONNECTION WITH THE PAYMENT OF ANY AND ALL AMOUNTS DUE UNDER THIS GUARANTEE.

(B) ALL PAYMENTS DUE UNDER THIS GUARANTEE SHALL BE MADE WITHOUT DEDUCTION FOR OR ON ACCOUNT OF ANY SUCH TAXES, DUTIES, FEES OR OTHER CHARGES.

(C) IF THE GUARANTOR IS PREVENTED BY OPERATION OF LAW OR OTHERWISE FROM MAKING OR CAUSING TO BE MADE SUCH PAYMENTS WITHOUT DEDUCTION, THE AMOUNTS DUE UNDER THIS GUARANTEE SHALL BE INCREASED, AND THE GUARANTOR SHALL PAY, SUCH AMOUNT AS MAY BE NECESSARY SO THAT IFC RECEIVES THE FULL AMOUNT IT WOULD HAVE RECEIVED (TAKING INTO ACCOUNT ANY SUCH TAXES, DUTIES, FEES OR OTHER CHARGES PAYABLE ON AMOUNTS PAYABLE BY THE GUARANTOR UNDER THIS SUBSECTION) HAD SUCH PAYMENTS BEEN MADE WITHOUT SUCH DEDUCTION.

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(D) IF SUBSECTION (C) ABOVE APPLIES AND IFC SO REQUIRES, THE GUARANTOR SHALL DELIVER TO IFC OFFICIAL TAX RECEIPTS EVIDENCING PAYMENT (OR CERTIFIED COPIES OF THEM) WITHIN THIRTY (30) DAYS OF THE DATE OF PAYMENT.

SECTION 2.05. CERTIFICATE CONCLUSIVE. A CERTIFICATE OF IFC STATING:

(A) THE AMOUNT OF THE GUARANTEED OBLIGATIONS DUE AND PAYABLE; OR

(B) ANY AMOUNT DUE AND PAYABLE BY THE GUARANTOR UNDER THIS GUARANTEE;

OR

(C) THE AMOUNT OF THE GUARANTEED OBLIGATIONS, WHETHER CURRENTLY DUE AND PAYABLE OR NOT,

SHALL BE CONCLUSIVE IN THE ABSENCE OF MANIFEST ERROR.

SECTION 2.06. APPLICATION OF PAYMENTS. IFC MAY APPLY ANY AMOUNTS RECEIVED BY IT OR RECOVERED UNDER:

(A) ANY IFC SECURITY; AND

(B) ANY OTHER DOCUMENT OR AGREEMENT WHICH IS A SECURITY FOR ANY OF THE GUARANTEED OBLIGATIONS AND ANY OTHER MONEYS, IN SUCH MANNER AS IT DETERMINES IN ITS ABSOLUTE DISCRETION.

SECTION 2.07. ALLOCATION. IF THE GUARANTOR AT ANY TIME PAYS TO IFC AN AMOUNT LESS THAN THE FULL AMOUNT THEN DUE AND PAYABLE TO IFC UNDER THIS GUARANTEE, IFC MAY ALLOCATE AND APPLY SUCH PAYMENT IN ANY WAY OR MANNER AND FOR SUCH PURPOSE OR PURPOSES AS IFC IN ITS SOLE DISCRETION DETERMINES, NOTWITHSTANDING ANY INSTRUCTION THAT THE GUARANTOR MIGHT GIVE TO THE CONTRARY.

ARTICLE III

SAVING PROVISIONS

SECTION 3.01. INCREASE IN GUARANTEED OBLIGATIONS. THE OBLIGATIONS OF THE GUARANTOR UNDER THIS GUARANTEE SHALL EXTEND TO ANY INCREASE IN THE GUARANTEED OBLIGATIONS AS A RESULT OF:

(A) ANY AMENDMENT, SUPPLEMENT, RENEWAL OR REPLACEMENT OF ANY TRANSACTION DOCUMENT; OR

(B) THE OCCURRENCE OF ANY OTHER THING; AND

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(C) REGARDLESS OF WHETHER THE GUARANTOR IS AWARE OF, CONSENTED TO OR IS GIVEN NOTICE OF ANY ALTERATION, VARIATION, AMENDMENT, SUPPLEMENT, RENEWAL OR REPLACEMENT OF ANY TRANSACTION DOCUMENT OR THE OCCURRENCE OF SUCH OTHER THING.

SECTION 3.02. WAIVER OF DEFENSES. THE GUARANTOR'S OBLIGATIONS UNDER THIS GUARANTEE SHALL BE IRREVOCABLE, ABSOLUTE AND UNCONDITIONAL, IRRESPECTIVE OF, AND SHALL NOT BE AFFECTED OR IMPAIRED BY, ANY ACT, OMISSION, CIRCUMSTANCE (OTHER THAN COMPLETE PAYMENT OF THE GUARANTEED OBLIGATIONS), MATTER OR THING WHICH, BUT FOR THIS PROVISION, WOULD REDUCE, RELEASE OR PREJUDICE ANY OF ITS OBLIGATIONS UNDER THIS GUARANTEE OR WHICH MIGHT OTHERWISE CONSTITUTE A LEGAL OR EQUITABLE DISCHARGE OR DEFENSE OF A SURETY OR A GUARANTOR, INCLUDING (WHETHER OR NOT KNOWN TO THE GUARANTOR OR TO IFC):

(A) ANY TIME, WAIVER, COMPOSITION, FORBEARANCE OR CONCESSION GIVEN TO THE COMPANY OR ANY OTHER PERSON;

(B) ANY ASSERTION OF, OR FAILURE TO ASSERT, OR DELAY IN ASSERTING, ANY RIGHT, POWER OR REMEDY AGAINST THE COMPANY OR ANY OTHER PERSON, OR IN RESPECT OF ANY SECURITY FOR THE LOAN;

(C) ANY TAKING, EXCHANGE, RELEASE OR NON-PERFECTION OF THE IFC SECURITY, OR ANY TAKING, RELEASE OR AMENDMENT OR WAIVER OF OR CONSENT TO DEPARTURE FROM ANY OTHER GUARANTY, FOR ALL OR ANY OF THE GUARANTEED OBLIGATIONS;

(D) ANY MANNER OF APPLICATION OF THE IFC SECURITY, OR PROCEEDS THEREOF, TO ALL OR ANY OF THE GUARANTEED OBLIGATIONS, OR ANY MANNER OF SALE OR OTHER DISPOSITION OF ANY COLLATERAL FOR ALL OR ANY OF THE GUARANTEED OBLIGATIONS UNDER THE TRANSACTION DOCUMENTS;

(E) ANY AMPLIFICATION, AMENDMENT (HOWEVER FUNDAMENTAL), VARIATION OR REPLACEMENT OF THE PROVISIONS OF ANY TRANSACTION DOCUMENT OR OF ANY OTHER AGREEMENT OR SECURITY BETWEEN IFC AND THE COMPANY;

(F) ANY FAILURE OF THE COMPANY OR THE GUARANTOR TO COMPLY WITH ANY REQUIREMENT OF ANY LAW, REGULATION OR ORDER;

(G) ANY CHANGE, RESTRUCTURING, REORGANIZATION OR TERMINATION OF THE LEGAL STATUS OR STRUCTURE OF THE COMPANY OR THE GUARANTOR;

(H) THE OCCURRENCE AND/OR CONTINUANCE OF ANY BANKRUPTCY, REORGANIZATION, ARRANGEMENT, ADJUSTMENT OF DEBT, RELIEF OF DEBTORS, DISSOLUTION, INSOLVENCY, LIQUIDATION OR SIMILAR PROCEEDINGS WITH RESPECT TO THE COMPANY OR THE GUARANTOR;

(I) ANY PURPORTED OR ACTUAL ASSIGNMENT OF THE LOAN BY IFC TO ANY OTHER PARTY; OR

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(J) THE CONVERTIBLE LOAN AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT BEING IN WHOLE OR IN PART ILLEGAL, VOID, VOIDABLE, AVOIDED, INVALID, UNENFORCEABLE OR OTHERWISE OF LIMITED FORCE AND EFFECT.

SECTION 3.03. IMMEDIATE RECOURSE. THE GUARANTOR WAIVES ANY RIGHT IT MAY HAVE OF FIRST REQUIRING IFC (OR ANY TRUSTEE, AGENT OR OTHER PERSON ACTING ON ITS BEHALF) TO PROCEED AGAINST OR ENFORCE ANY OTHER RIGHTS OR SECURITY OR CLAIM PAYMENT FROM ANY PERSON BEFORE CLAIMING FROM THE GUARANTOR UNDER THIS GUARANTEE.

SECTION 3.04. SUBROGATION. IF ANY AMOUNTS HAVE BECOME PAYABLE OR HAVE BEEN PAID BY THE GUARANTOR UNDER THIS GUARANTEE, THE GUARANTOR SHALL NOT, IN RESPECT OF SUCH MONIES, SEEK TO ENFORCE REPAYMENT, OBTAIN THE BENEFIT OF ANY SECURITY OR EXERCISE ANY OTHER RIGHTS OR LEGAL REMEDIES OF ANY KIND WHICH MAY ACCRUE TO THE GUARANTOR AGAINST THE COMPANY, WHETHER BY WAY OF SUBROGATION, OFFSET, COUNTERCLAIM OR OTHERWISE, WHETHER OR NOT SUCH RIGHTS OR LEGAL REMEDY ARISE IN EQUITY OR UNDER CONTRACT, STATUTE OR COMMON LAW, IN RESPECT OF THE AMOUNT SO PAYABLE OR SO PAID (OR IN RESPECT OF ANY OTHER MONIES FOR THE TIME BEING DUE TO THE GUARANTOR FROM THE COMPANY) IF AND FOR SO LONG AS (I) ANY MONIES WHICH HAVE BECOME PAYABLE TO IFC UNDER THE CONVERTIBLE LOAN AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT REMAIN UNPAID, OR (II) ANY OTHER EVENT OF DEFAULT (OR EVENT WHICH WITH NOTICE, LAPSE OF TIME OR BOTH WOULD BECOME AN EVENT OF DEFAULT) IS IN EXISTENCE. THE GUARANTOR SHALL HOLD IN TRUST FOR, AND FORTHWITH PAY OR TRANSFER TO, IFC ANY PAYMENT OR DISTRIBUTION OR BENEFIT OF SECURITY RECEIVED BY IT CONTRARY TO THIS SECTION 3.04.

SECTION 3.05. BANKRUPTCY OR LIQUIDATION OF COMPANY. IF THE COMPANY BECOMES BANKRUPT, ENTERS INTO A COMPOSITION OR MAKES ANY ARRANGEMENT WITH ITS CREDITORS, OR IS DISSOLVED, LIQUIDATED OR WOUND UP, THE GUARANTOR SHALL NOT CLAIM, RANK, PROVE OR VOTE AS A CREDITOR OF THE COMPANY OR ITS ESTATE IN COMPETITION WITH IFC IN RESPECT OF ANY AMOUNTS OWING TO THE GUARANTOR BY THE COMPANY ON ANY ACCOUNT WHATSOEVER, BUT INSTEAD SHALL GIVE IFC THE BENEFIT OF ANY SUCH PROOF AND OF ALL AMOUNTS TO BE RECEIVED IN RESPECT OF THAT PROOF UNTIL ALL GUARANTEED OBLIGATIONS HAVE BEEN FULLY PAID. THE GUARANTOR SHALL HOLD IN TRUST FOR, AND FORTHWITH PAY OR TRANSFER TO, IFC ANY PAYMENT OR DISTRIBUTION OR BENEFIT OF SECURITY RECEIVED BY IT CONTRARY TO THIS SECTION 3.05.

SECTION 3.06. APPROPRIATION OF MONEYS. UNTIL ALL OF THE GUARANTEED OBLIGATIONS HAVE BEEN IRREVOCABLY PAID IN FULL, IFC (OR ANY TRUSTEE, AGENT OR OTHER PERSON ACTING ON ITS BEHALF) MAY:

(A) REFRAIN FROM APPLYING OR ENFORCING ANY OTHER MONEYS, SECURITY OR

RIGHTS HELD OR RECEIVED BY IFC (OR SUCH TRUSTEE, AGENT OR OTHER PERSON) IN RESPECT OF THE GUARANTEED OBLIGATIONS, OR APPLY AND ENFORCE THE SAME IN SUCH MANNER AND ORDER AS IT SEES FIT (WHETHER AGAINST THE GUARANTEED OBLIGATIONS OR OTHERWISE) AND THE GUARANTOR SHALL NOT BE ENTITLED TO THE BENEFIT OF THE SAME; AND

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(B) HOLD AND KEEP FOR SUCH TIME AS IT THINKS PRUDENT ANY MONIES RECEIVED, RECOVERED OR REALIZED UNDER THIS GUARANTEE, TO THE CREDIT EITHER OF THE GUARANTOR OR SUCH OTHER PERSON OR PERSONS AS IT THINKS FIT.

SECTION 3.07. RESTRUCTURING. (A) IFC SHALL, WITHOUT THE CONSENT OF THE GUARANTOR, BE ENTITLED TO RESCHEDULE OR RESTRUCTURE PRINCIPAL, INTEREST AND OTHER AMOUNTS PAYABLE UNDER THE CONVERTIBLE LOAN AGREEMENT, TO RELEASE THE COMPANY FROM ITS OBLIGATIONS THEREUNDER AND/OR TO ACCEPT A NEW DEBTOR. THE GUARANTOR'S LIABILITY UNDER THIS GUARANTY SHALL NOT BE AFFECTED BY SUCH MEASURES, AND THE GUARANTOR UNDERTAKES TO PAY IFC IN ACCORDANCE WITH THE TERMS HEREOF, ALL SUCH AMOUNTS IN FULL WHEN DUE.

(B) IFC (OR ANY TRUSTEE, AGENT OR OTHER PERSON ACTING ON ITS BEHALF) MAY CONCEDE OR COMPROMISE ANY CLAIM THAT ANY PAYMENT, SECURITY OR OTHER DISPOSITION IS LIABLE TO AVOIDANCE OR RESTORATION.

SECTION 3.08. ADDITIONAL SECURITY. THIS GUARANTEE IS IN ADDITION TO AND IS NOT IN ANY WAY PREJUDICED BY ANY OTHER COMPONENT OF THE IFC SECURITY, OR ANY COLLATERAL OR OTHER SECURITY NOW OR HEREAFTER HELD BY IFC, NOR SHALL SUCH COLLATERAL OR OTHER SECURITY HELD BY IFC OR THE LIABILITY OF ANY PERSON FOR ALL OR ANY PART OF THE GUARANTEED OBLIGATIONS BE IN ANY MANNER PREJUDICED OR AFFECTED BY THIS GUARANTEE.

ARTICLE IV

INDEMNITY

SECTION 4.01. INDEMNITY. (A) IF ANY OF THE GUARANTEED OBLIGATIONS ARE IRRECOVERABLE FROM THE COMPANY, OR NOT RECOVERABLE BY IFC FROM THE GUARANTOR ON THE BASIS OF A GUARANTEE, THEN THE GUARANTOR:

(I) SHALL PAY TO IFC AN AMOUNT EQUAL TO THE GUARANTEED OBLIGATIONS UP TO ITS PRO-RATA SHARE; AND

(II) SHALL INDEMNIFY IFC AGAINST ANY CLAIM, ACTION, DAMAGE, LOSS, LIABILITY, COST, CHARGE AND EXPENSE, OUTGOING OR PAYMENT SUFFERED, PAID OR INCURRED BY IFC IN RELATION TO THE NON-PAYMENT OF THE GUARANTEED OBLIGATIONS UP TO ITS PRO-RATA SHARE.

(B) PARAGRAPH (A) ABOVE APPLIES TO ANY GUARANTEED OBLIGATIONS WHICH ARE OR MAY BE IRRECOVERABLE IRRESPECTIVE OF WHETHER:

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(I) THEY ARE OR MAY BE IRRECOVERABLE BY REASON OF ANY EVENT DESCRIBED IN SECTION 4.01; OR

(II) THE TRANSACTIONS OR ANY OF THEM RELATING TO THOSE MONEYS ARE VOID OR ILLEGAL OR AVOIDED OR OTHERWISE UNENFORCEABLE; OR

(III) THEY ARE OR MAY BE IRRECOVERABLE BY REASON OF ANY OTHER FACT OR CIRCUMSTANCE WHATSOEVER; OR

(IV) ANY OTHER MATTERS RELATING TO THE GUARANTEED OBLIGATIONS ARE OR SHOULD HAVE BEEN WITHIN THE KNOWLEDGE OF IFC.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

SECTION 5.01. REPRESENTATIONS AND WARRANTIES. THE GUARANTOR REPRESENTS AND WARRANTS THAT AS OF THE DATE OF THIS GUARANTEE:

(A) IT IS A COMPANY DULY ORGANIZED, VALIDLY EXISTING, AND IN GOOD STANDING UNDER THE LAWS OF ITS JURISDICTION OF INCORPORATION, AND HAS THE CORPORATE POWER TO ENTER INTO AND DELIVER AND TO PERFORM ITS OBLIGATIONS UNDER THIS GUARANTEE;

(B) THE EXECUTION AND DELIVERY BY IT OF THIS GUARANTEE AND THE PERFORMANCE BY IT OF ITS OBLIGATIONS HEREUNDER HAVE BEEN DULY AUTHORIZED;

(C) THIS GUARANTEE HAS BEEN DULY EXECUTED BY IT AND CONSTITUTES ITS VALID AND LEGALLY BINDING OBLIGATIONS ENFORCEABLE IN ACCORDANCE WITH ITS TERMS AND WOULD BE SO TREATED IN THE COURTS OF ITS PLACE OF INCORPORATION AND ANY OTHER JURISDICTION TO WHICH THE GUARANTOR HAS AGREED TO SUBMIT IN THIS GUARANTEE;

(D) NEITHER THE EXECUTION AND DELIVERY BY IT OF THIS GUARANTEE NOR THE PERFORMANCE BY IT OF ITS OBLIGATIONS UNDER THIS GUARANTEE CONFLICTS OR WILL CONFLICT WITH OR RESULT IN ANY BREACH OF ANY OF THE TERMS, CONDITIONS OR PROVISIONS OF, OR VIOLATE OR CONSTITUTE A DEFAULT OR REQUIRE ANY CONSENT UNDER:

(I) ANY INDENTURE, MORTGAGE, CONTRACT, AGREEMENT OR OTHER INSTRUMENT OR ARRANGEMENT TO WHICH IT IS A PARTY OR WHICH PURPORTS TO BE BINDING UPON IT OR ANY OF ITS PROPERTY OR ASSETS, AND WILL NOT RESULT IN THE IMPOSITION OR CREATION OF ANY LIEN, CHARGE, OR ENCUMBRANCE ON, OR SECURITY

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INTEREST IN, ANY PART THEREOF PURSUANT TO THE PROVISIONS OF ANY SUCH AGREEMENT, INSTRUMENT OR ARRANGEMENT; OR

(II) ANY OF THE TERMS OR PROVISIONS OF ITS MEMORANDUM AND ARTICLES OF ASSOCIATION; OR

(III) ANY STATUTE, RULE OR REGULATION OR ANY JUDGEMENT, DECREE OR ORDER OF ANY COURT, GOVERNMENTAL AUTHORITY, BUREAU OR AGENCY BINDING ON OR APPLICABLE TO IT; AND

(E) ALL AUTHORIZATIONS REQUIRED FOR THE EXECUTION AND DELIVERY OF THIS GUARANTEE BY IT AND THE PERFORMANCE BY IT OF ITS OBLIGATIONS HEREUNDER, HAVE BEEN DULY OBTAINED OR GRANTED AND ARE IN FULL FORCE AND EFFECT.

SECTION 5.02. IFC RELIANCE. (A) THE GUARANTOR ACKNOWLEDGES THAT IT MAKES THE REPRESENTATIONS IN SECTION 5.01 WITH THE INTENTION OF INDUCING IFC TO

ENTER INTO THIS AGREEMENT AND THE CONVERTIBLE LOAN AGREEMENT AND THAT IFC ENTERS INTO THIS AGREEMENT AND THE CONVERTIBLE LOAN AGREEMENT ON THE BASIS OF, AND IN FULL RELIANCE ON, EACH OF SUCH REPRESENTATIONS.

(B) THE GUARANTOR WARRANTS TO IFC THAT EACH OF SUCH REPRESENTATIONS IS TRUE AND CORRECT IN ALL MATERIAL RESPECTS AS OF THE DATE OF THIS AGREEMENT AND THAT NONE OF THEM OMITS OR MISSTATES ANY MATTER THE OMISSION OR MISSTATEMENT OF WHICH MAKES ANY OF SUCH REPRESENTATIONS MISLEADING.

SECTION 5.03. RIGHTS AND REMEDIES NOT LIMITED. IFC'S RIGHTS AND REMEDIES IN RELATION TO ANY MISREPRESENTATION OR BREACH OF WARRANTY ON THE PART OF THE GUARANTOR ARE NOT PREJUDICED:

(A) BY ANY INVESTIGATION BY OR ON BEHALF OF IFC INTO THE AFFAIRS OF THE GUARANTOR;

(B) BY THE EXECUTION OR THE PERFORMANCE OF THIS AGREEMENT; OR

(C) BY ANY OTHER ACT OR THING WHICH MAY BE DONE BY OR ON BEHALF OF IFC IN CONNECTION WITH THIS AGREEMENT AND WHICH MIGHT, APART FROM THIS SECTION, PREJUDICE SUCH RIGHTS OR REMEDIES.

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ARTICLE VI

COVENANTS

SECTION 6.01. GUARANTOR'S COVENANTS. THE GUARANTOR SHALL:

(A) WHEN REQUESTED BY IFC, DO OR CAUSE TO BE DONE ANYTHING WHICH AIDS THE EXERCISE OF ANY POWER, RIGHT OR REMEDY OF IFC UNDER THIS GUARANTEE INCLUDING, BUT NOT LIMITED TO, THE EXECUTION OF ANY DOCUMENT OR AGREEMENT;

(B) OBTAIN, MAINTAIN AND RENEW WHEN NECESSARY ALL AUTHORIZATIONS REQUIRED UNDER ANY LAW OR DOCUMENT OR AGREEMENT:

(I) TO ENABLE IT TO PERFORM ITS OBLIGATIONS UNDER THIS GUARANTEE; OR

(II) FOR THE VALIDITY OR ENFORCEABILITY OF THE GUARANTEE;

(C) COMPLY IN ALL RESPECTS WITH THE TERMS OF THE AUTHORIZATIONS REFERRED TO IN PARAGRAPH (B) ABOVE;

(D) AS SOON AS AVAILABLE, BUT, IN ANY EVENT, WITHIN FORTY FIVE (45) DAYS AFTER THE END OF EACH QUARTER OF EACH FISCAL YEAR, FURNISH TO IFC:

(I) TWO (2) COPIES OF ITS FINANCIAL STATEMENTS FOR SUCH PERIOD PREPARED IN ACCORDANCE WITH UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND CONSISTENTLY APPLIED; AND

(II) A REPORT ON ANY FACTORS MATERIALLY AND ADVERSELY AFFECTING OR WHICH ARE LIKELY TO MATERIALLY AND ADVERSELY AFFECT ITS BUSINESS AND OPERATIONS OR FINANCIAL CONDITION; AND

(E) AS SOON AS AVAILABLE, BUT, IN ANY EVENT, WITHIN ONE HUNDRED AND TWENTY (120) DAYS AFTER THE END OF EACH FISCAL YEAR, FURNISH TO IFC:

(I) TWO (2) COPIES OF THE ITS FINANCIAL STATEMENTS FOR SUCH

FISCAL YEAR (WHICH ARE IN AGREEMENT WITH ITS BOOKS OF ACCOUNT AND PREPARED IN ACCORDANCE WITH UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES CONSISTENTLY APPLIED), TOGETHER WITH AN AUDIT REPORT ON THEM, ALL IN FORM SATISFACTORY TO IFC; AND

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(II) A REPORT ON ANY FACTORS MATERIALLY AND ADVERSELY AFFECTING OR WHICH ARE LIKELY TO MATERIALLY AND ADVERSELY AFFECT ITS BUSINESS AND OPERATIONS OR FINANCIAL CONDITION.

ARTICLE VII

MISCELLANEOUS

SECTION 7.01. NOTICES. ANY NOTICE, REQUEST OR OTHER COMMUNICATION TO BE GIVEN OR MADE UNDER THIS GUARANTEE SHALL BE IN WRITING. THE NOTICE, REQUEST OR OTHER COMMUNICATION MAY BE DELIVERED BY HAND, AIRMAIL, FACSIMILE, OR TELEX TO THE PARTY'S ADDRESS SPECIFIED BELOW OR AT SUCH OTHER ADDRESS AS SUCH PARTY NOTIFIES TO THE OTHER PARTY FROM TIME TO TIME AND WILL BE EFFECTIVE UPON RECEIPT.

FOR THE GUARANTOR:

CANARGO ENERGY CORPORATION
P.O. BOX 291
COMMERCE HOUSE, LES BANQUES
ST. PETER PORT, GUERNSEY, GY1 3RR
BRITISH ISLES

ATTENTION: CHAIRMAN

FACSIMILE: 44-1481-729-982

WITH A COPY SENT TO:

CANARGO ENERGY CORPORATION
SUITE 1580, 727 - 7TH AVENUE S.W.
CALGARY, ALBERTA, CANADA
T2P 0Z5

ATTENTION: PRESIDENT

FACSIMILE: (403) 777-1578

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FOR IFC:

INTERNATIONAL FINANCE CORPORATION
2121 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20433
UNITED STATES OF AMERICA

ATTENTION: DIRECTOR, OIL, GAS AND MINING DEPARTMENT

FACSIMILE: (202) 974-4322

WITH A COPY (IN THE CASE OF NOTICES RELATING TO PAYMENTS) TO:

MANAGER, ACCOUNTING DIVISION

FACSIMILE: (202) 974-4371

SECTION 7.02. ENGLISH LANGUAGE. ALL DOCUMENTS TO BE FURNISHED OR COMMUNICATIONS TO BE GIVEN OR MADE UNDER THIS GUARANTEE SHALL BE IN THE ENGLISH LANGUAGE OR, IF IN ANOTHER LANGUAGE, SHALL BE ACCOMPANIED BY A TRANSLATION INTO ENGLISH SATISFACTORY TO IFC CERTIFIED BY A REPRESENTATIVE OF THE GUARANTOR, WHICH TRANSLATION SHALL BE THE GOVERNING VERSION BETWEEN THE GUARANTOR AND IFC.

SECTION 7.03. EXPENSES. THE GUARANTOR SHALL PAY TO IFC OR AS IFC MAY DIRECT THE COSTS AND EXPENSES INCURRED BY IFC IN RELATION TO THE ENFORCEMENT OR PROTECTION OR ATTEMPTED ENFORCEMENT OR PROTECTION OF ITS RIGHTS UNDER THIS GUARANTEE, INCLUDING LEGAL AND OTHER PROFESSIONAL CONSULTANTS' FEES AND EXPENSES ON A FULL INDEMNITY BASIS.

SECTION 7.04. REMEDIES AND WAIVERS. NO FAILURE OR DELAY BY IFC IN EXERCISING ANY POWER, REMEDY, DISCRETION, AUTHORITY OR OTHER RIGHTS UNDER THIS GUARANTEE SHALL WAIVE OR IMPAIR THAT OR ANY OTHER RIGHT OF IFC. NO SINGLE OR PARTIAL EXERCISE OF SUCH A RIGHT SHALL PRECLUDE ITS ADDITIONAL OR FUTURE EXERCISE. NO SUCH WAIVER SHALL WAIVE ANY OTHER RIGHT UNDER THIS GUARANTEE. ALL WAIVERS OR CONSENTS GIVEN UNDER THIS GUARANTEE SHALL BE IN WRITING.

SECTION 7.05. JURISDICTION AND ENFORCEMENT. (A) THIS AGREEMENT IS GOVERNED BY, AND SHALL BE CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK, UNITED STATES OF AMERICA.

(B) THE GUARANTOR IRREVOCABLY AGREES THAT ANY LEGAL ACTION, SUIT OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT TO WHICH IT IS A PARTY MAY BE BROUGHT BY IFC IN THE COURTS OF THE STATE OF NEW YORK OR OF THE UNITED STATES OF AMERICA LOCATED IN THE SOUTHERN DISTRICT OF NEW YORK. FINAL JUDGMENT AGAINST THE GUARANTOR IN ANY SUCH

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ACTION, SUIT OR PROCEEDING SHALL BE CONCLUSIVE AND MAY BE ENFORCED IN ANY OTHER JURISDICTION, BY SUIT ON THE JUDGMENT, A CERTIFIED OR EXEMPLIFIED COPY OF WHICH SHALL BE CONCLUSIVE EVIDENCE OF THE JUDGMENT, OR IN ANY OTHER MANNER PROVIDED BY LAW.

(C) BY THE EXECUTION AND DELIVERY OF THIS AGREEMENT, THE GUARANTOR IRREVOCABLY SUBMITS TO THE NON-EXCLUSIVE JURISDICTION OF ANY SUCH COURT IN ANY SUCH ACTION, SUIT OR PROCEEDING AND DESIGNATES, APPOINTS AND EMPOWERS AS ITS AUTHORIZED AGENT TO RECEIVE FOR AND ON ITS BEHALF SERVICE OF ANY SUMMONS, COMPLAINT OR OTHER LEGAL PROCESS IN ANY SUCH ACTION, SUIT OR PROCEEDING IN THE STATE OF NEW YORK.

(D) NOTHING IN THIS AGREEMENT SHALL AFFECT THE RIGHT OF IFC TO COMMENCE LEGAL PROCEEDINGS OR OTHERWISE SUE THE GUARANTOR IN ANY JURISDICTION, OR CONCURRENTLY IN MORE THAN ONE JURISDICTION, OR TO SERVE PROCESS, PLEADINGS AND OTHER LEGAL PAPERS UPON THE GUARANTOR IN ANY MANNER AUTHORIZED BY THE LAWS OF ANY SUCH JURISDICTION.

(E) AS LONG AS THIS AGREEMENT REMAINS IN FORCE, THE GUARANTOR SHALL MAINTAIN A DULY APPOINTED AGENT FOR THE SERVICE OF SUMMONS, COMPLAINT AND OTHER

LEGAL PROCESS IN NEW YORK, NEW YORK, UNITED STATES OF AMERICA, FOR PURPOSES OF ANY LEGAL ACTION, SUIT OR PROCEEDING IFC MAY BRING IN RESPECT OF THIS AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT TO WHICH THE GUARANTOR IS A PARTY. THE GUARANTOR SHALL KEEP IFC ADVISED OF THE IDENTITY AND LOCATION OF SUCH AGENT.

(F) THE GUARANTOR ALSO IRREVOCABLY CONSENTS, IF FOR ANY REASON THE GUARANTOR'S AUTHORIZED AGENT FOR SERVICE OF PROCESS OF SUMMONS, COMPLAINT AND OTHER LEGAL PROCESS IN ANY SUCH ACTION, SUIT OR PROCEEDING IS NOT PRESENT IN NEW YORK, NEW YORK, TO SERVICE OF SUCH PAPERS BEING MADE OUT OF THOSE COURTS BY MAILING COPIES OF THE PAPERS BY REGISTERED UNITED STATES AIR MAIL, POSTAGE PREPAID, TO THE GUARANTOR AT ITS ADDRESS SPECIFIED IN SECTION 7.01. IN SUCH A CASE, IFC SHALL ALSO SEND BY TELEX OR FACSIMILE, OR HAVE SENT BY TELEX OR FACSIMILE, A COPY OF THE PAPERS TO THE GUARANTOR.

(G) SERVICE IN THE MANNER PROVIDED IN SUBSECTION (F) ABOVE IN ANY SUCH ACTION, SUIT OR PROCEEDING WILL BE DEEMED PERSONAL SERVICE, WILL BE ACCEPTED BY THE GUARANTOR AS SUCH AND WILL BE VALID AND BINDING UPON THE GUARANTOR FOR ALL PURPOSES OF ANY SUCH ACTION, SUIT OR PROCEEDING.

(H) THE GUARANTOR IRREVOCABLY WAIVES TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW:

(I) ANY OBJECTION WHICH IT MAY HAVE NOW OR IN THE FUTURE TO THE LAYING OF THE VENUE OF ANY SUCH ACTION, SUIT OR PROCEEDING IN ANY COURT REFERRED TO IN THIS SECTION;

(II) ANY CLAIM THAT ANY SUCH ACTION, SUIT OR PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM; AND

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(III) ITS RIGHT OF REMOVAL OF ANY MATTER COMMENCED BY IFC IN THE COURTS OF THE STATE OF NEW YORK TO ANY COURT OF THE UNITED STATES OF AMERICA.

(I) TO THE EXTENT THAT THE GUARANTOR MAY BE ENTITLED IN ANY JURISDICTION TO CLAIM FOR ITSELF OR ITS ASSETS IMMUNITY IN RESPECT OF ITS OBLIGATIONS UNDER THIS AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT TO WHICH THE GUARANTOR IS A PARTY FROM ANY SUIT, EXECUTION, ATTACHMENT (WHETHER PROVISIONAL OR FINAL, IN AID OF EXECUTION, BEFORE JUDGMENT OR OTHERWISE) OR OTHER LEGAL PROCESS OR TO THE EXTENT THAT IN ANY JURISDICTION SUCH IMMUNITY (WHETHER OR NOT CLAIMED) MAY BE ATTRIBUTED TO IT OR ITS ASSETS, THE GUARANTOR IRREVOCABLY AGREES NOT TO CLAIM AND IRREVOCABLY WAIVES SUCH IMMUNITY TO THE FULLEST EXTENT PERMITTED BY THE LAWS OF SUCH JURISDICTION.

(J) THE GUARANTOR HEREBY ACKNOWLEDGES THAT IFC SHALL BE ENTITLED UNDER APPLICABLE LAW, INCLUDING THE PROVISIONS OF THE INTERNATIONAL ORGANIZATIONS IMMUNITIES ACT, TO IMMUNITY FROM A TRIAL BY JURY IN ANY ACTION, SUIT OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY OR ANY OTHER TRANSACTION DOCUMENT TO WHICH THE GUARANTOR IS A PARTY, BROUGHT AGAINST IFC IN ANY COURT OF THE UNITED STATES OF AMERICA. THE COMPANY HEREBY WAIVES ANY AND ALL RIGHTS TO DEMAND A TRIAL BY JURY IN ANY ACTION, SUIT OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT TO WHICH THE GUARANTOR IS A PARTY OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT OR SUCH TRANSACTION DOCUMENTS, BROUGHT AGAINST IFC IN ANY FORUM IN WHICH IFC IS NOT ENTITLED TO IMMUNITY FROM A TRIAL BY JURY.

(K) TO THE EXTENT THAT THE GUARANTOR MAY, IN ANY SUIT, ACTION OR PROCEEDING BROUGHT IN ANY OF THE COURTS REFERRED TO IN PARAGRAPH (B) ABOVE OR ELSEWHERE ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT OR ANY OTHER TRANSACTION DOCUMENT TO WHICH THE GUARANTOR IS A PARTY, BE ENTITLED TO THE

BENEFIT OF ANY PROVISION OF LAW REQUIRING IFC IN SUCH SUIT, ACTION OR PROCEEDING TO POST SECURITY FOR THE COSTS OF THE GUARANTOR (CAUTIO JUDICATUM SOLVI), OR TO POST A BOND OR TO TAKE SIMILAR ACTION, THE GUARANTOR HEREBY IRREVOCABLY WAIVES SUCH BENEFIT, IN EACH CASE TO THE FULLEST EXTENT NOW OR IN THE FUTURE PERMITTED UNDER THE LAWS OF THE JURISDICTION IN WHICH SUCH COURT IS LOCATED.

SECTION 7.06. CONFIDENTIAL INFORMATION. (A) IFC MAY DISCLOSE TO ANY PERSON FOR THE PURPOSE OF EXERCISING ANY POWER, REMEDY, RIGHT, AUTHORITY, OR DISCRETION UNDER THIS GUARANTEE OR ANY OTHER TRANSACTION DOCUMENT IN CONNECTION WITH AN EVENT OF DEFAULT, ANY DOCUMENTS OR RECORDS OF, OR INFORMATION ABOUT, THIS GUARANTEE OR THE ASSETS, BUSINESS OR AFFAIRS OF THE GUARANTOR.

(B) THE GUARANTOR ACKNOWLEDGES AND AGREES THAT, NOTWITHSTANDING THE TERMS OF ANY OTHER AGREEMENT BETWEEN THE GUARANTOR AND IFC, A DISCLOSURE OF INFORMATION BY IFC IN THE CIRCUMSTANCES CONTEMPLATED BY THIS SECTION DOES NOT VIOLATE ANY DUTY OWED TO THE GUARANTOR OR AGREEMENT BETWEEN IFC AND THE GUARANTOR.

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SECTION 7.07. SUCCESSORS AND ASSIGNS. THIS GUARANTEE BINDS AND INURES TO THE BENEFIT OF THE RESPECTIVE SUCCESSORS AND ASSIGNS OF THE PARTIES, EXCEPT THAT THE GUARANTOR MAY NOT ASSIGN OR OTHERWISE TRANSFER ALL OR ANY PART OF ITS RIGHTS OR OBLIGATIONS UNDER THIS GUARANTEE WITHOUT THE PRIOR WRITTEN CONSENT OF IFC. THE BENEFIT OF THIS GUARANTEE MAY BE FREELY AND UNCONDITIONALLY ASSIGNED, TRANSFERRED OR OTHERWISE DISPOSED OF, IN WHOLE OR IN PART, BY IFC TO ANY OTHER PERSON, CORPORATE OR OTHERWISE.

SECTION 7.08. AMENDMENT. ANY AMENDMENT OF ANY PROVISION OF THIS GUARANTEE SHALL BE IN WRITING AND SIGNED BY THE PARTIES.

SECTION 7.09. COUNTERPARTS. THIS GUARANTEE MAY BE EXECUTED IN SEVERAL COUNTERPARTS, EACH OF WHICH IS AN ORIGINAL, BUT ALL OF WHICH TOGETHER CONSTITUTE ONE AND THE SAME AGREEMENT.

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IN WITNESS WHEREOF, THE PARTIES HAVE EXECUTED THIS GUARANTEE AS OF THE DATE FIRST ABOVE WRITTEN.

CANARGO ENERGY CORPORATION

BY: /S/ MICHAEL BINNION
NAME:
TITLE: AUTHORIZED REPRESENTATIVE

INTERNATIONAL FINANCE CORPORATION

BY: /S/ MARIA DA GRACA DOMINGUES
NAME:

TITLE: AUTHORIZED REPRESENTATIVE

</TEXT>
</DOCUMENT>
<DOCUMENT>
<TYPE>EX-10.21
<SEQUENCE>6
<DESCRIPTION>AGREEMENT BETWEEN GEORGIAN OIL REFINERY COMPANY
<TEXT>

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EXHIBIT 10(21)

AGREEMENT IN PRINCIPLE
CONCERNING PARTICIPATION BY
CANARGO
IN THE
GEORGIAN AMERICAN OIL REFINERY

This Agreement in Principle ("AIP") is by and between CanArgo Petroleum Products Limited ("CanArgo") a legal entity registered in Guernsey, British Isles, the Georgian American Oil Refinery ("GAOR"), a legal entity registered in the Republic of Georgia, State Company Georgian Oil ("Georgian Oil") a legal entity registered in the Republic of Georgia, Georgian British Oil Service Company ("GBOSC") a legal entity registered in the Republic of Georgia, and Argonaut Oil & Gas Ltd ("Argonaut") a legal entity registered in Cyprus (CanArgo, GAOR, Georgian Oil, GBOSC and Argonaut are hereinafter referred to as the "Parties" or "Party") concerns participation by CanArgo in GAOR, and in the refinery in Sartichala, Georgia.

WHEREAS,

- A. GAOR was created and founded by Georgian Oil (34% ownership) GBOSC (33% ownership) and Argonaut (33% ownership) in September 1997, with a current Charter Capital of \$30,000 and,
- B. GAOR is the owner of an oil refinery located in Sartichala, Republic of Georgia (the "Refinery"), and,
- C. CanArgo sister companies are involved in exploration & production of oil and gas in the Republic of Georgia through Ninotsminda Oil Company and CanArgo (Nazvrevi) Ltd, and,
- D. CanArgo and GAOR wish to conclude an agreement through which CanArgo becomes a shareholder of GAOR and participates in the Refinery and the current shareholders of GAOR, namely Georgian Oil, GBOSC and Argonaut Oil wish to invite CanArgo to become a shareholder in GAOR to develop the operation of the Refinery, according to priorities given below:

The First Phase of GAOR operation The Refinery is located in Sartichala, Georgia. Capacity of the Refinery is 2,000 barrels per day.

The Refinery is designed to process locally produced crude oil and imported oil. Phase I represents the market entry position for GAOR.

Products produced are:

- 1. Naphtha (for gasoline blending)
- 2. Diesel (For vehicles)
- 3. Mazut

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The local market in Georgia will consume all the products produced in GAOR Phase I. After a three to six month market entry posture, the GAOR is projected to

make an annual profit of \$2,624,000. After Profit Tax and taking into consideration depreciation fund annual cash flow of GAOR, which will be split between share holders, is estimated to generate annually \$2,496,000.

The Second Phase of GAOR operation includes expansion, the doubling in size of the crude oil fractionation process to 4,000 barrels per day.

Phase II products produced by GAOR upon completion will be:

1. Naphtha
2. Jet Fuel
3. Diesel
4. Mazut

After completion of Phase II GAOR is projected to make annual balance profit of \$6,194,000. After Profit Tax and considering depreciation fund GAOR annual cash flow, which will be split between the share holders are estimated to make \$5,611,000. This Phase is scheduled for commencement no later than end of the second quarter of 1999. Future expansion plans will be formulated based on the market conditions in Georgia, income generated by GAOR and amount of crude oil.

Long term plans for GAOR are as follows:

1. Increase of its market share
2. Installation of a catalytic reformer or cracker to produce high octane gasoline
3. Increase of Refinery capacity and optimization of its profitability
4. Establishment of brand recognition
5. Distributor base development
6. Determination of retail outlets
7. Development of export markets

At August 31, 1998 GAOR has no debts other than \$2,470,653 to Argonaut and GBOSC.

WHEREAS CanArgo has been familiarised with the main priorities of the Refinery development, agrees with them and is willing to become one of the owners and investors of the Refinery,

NOW HEREBY THE PARTIES AGREE AS FOLLOWS:

- 1) It is agreed that Argonaut and GBOSC (the "Primary Financiers") have provided finance to the sum of \$2,342,653 to GAOR (\$1,661,653 from Argonaut and \$681,000 from GBOSC), and that this funding is to be recovered from 50% of the after tax net profit of GAOR as detailed in Article 6.1 of the GAOR Foundation Agreement. This financing is on an

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interest free basis. Although the Primary Financiers will begin obtaining repayment of this finance from the profits made in the First Phase it is unlikely that all of this finance will have been recovered by the time the Second Phase becomes operational. In this event there would be "Primary Financier Unrecovered Investments".

- 2) The approximate cost of second 2,000 barrel per day capacity equipment purchase, transportation, installation of additional tanks and creation of infrastructure connected with it ("Second Equipment) is \$1,860,000. The mentioned investment shall be made by CanArgo in order to become 24% owner of the Refinery.
- 3) CanArgo will commence recovering the investments from the moment

that the Second Equipment becomes operational, or at the latest 30th June 1999, according to the following principle: 50% of GAOR's after tax net profit will go to recovering the investments in proportion to the unrecovered investment provided by each financier. For example: if the total unrecovered investment is \$3,500,000 (i.e. Primary Financier Unrecovered Investments plus CanArgo unrecovered investments) and CanArgo's unrecoverable investments are \$1,860,000 then CanArgo's share from total recoverable amount will be $1,860,000/3,500,000 = 53.1\%$, this being 53.1% of 50% of GAOR's after tax net profit.

- 4) The remaining 50% of after tax net profits of GAOR will be divided out to the shareholders in proportion to their ownership in GAOR at that time. This principle will apply to CanArgo will from the moment that the Second Equipment becomes operational, or at the latest 30th June 1999.
- 5) CanArgo shall gain it's ownership in the following manner:
 - a) On or before 12th September 1998 CanArgo shall make its First Contribution and transfer \$500,000 as investment to GAOR's account, and the Charter Capital of GAOR shall be increased by \$2,069 to \$32,069 with CanArgo paying \$2,069 into the Charter Capital. For this contribution CanArgo shall gain a 6.4516% interest and ownership in GAOR and GAOR's Charter Capital at the moment the First Contribution is received in GAOR's account. GAOR, GBOSC, Georgian Oil and Argonaut undertake to register CanArgo's interest in GAOR within two weeks of receiving the Contribution, and the GAOR Foundation Agreements will be modified to incorporate CanArgo and the principles of this AIP.
 - b) On or before 19th October 1998 CanArgo shall make its Second Contribution and transfer a further \$500,000 as investment to GAOR's account, and the Charter Capital of GAOR shall be

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increased by \$2,376 to \$34,444 with CanArgo paying \$2,376 into the Charter Capital. For this contribution CanArgo shall gain a further 6.4516% interest (total interest 12.9032%) and ownership in GAOR and GAOR's Charter Capital at the moment the Second Contribution is received in GAOR's account. GAOR, GBOSC, Georgian Oil and Argonaut undertake to register CanArgo's increased interest in GAOR within two weeks of receiving the Contribution.

- c) On or before 31st December 1998 CanArgo shall make its Third Contribution and transfer a third sum of \$500,000 as investment to GAOR's account, and the Charter Capital of GAOR shall be increased by \$2,756 to \$37,200 with CanArgo paying \$2,756 into the Charter Capital. For this contribution CanArgo shall gain a further 6.4516% interest (total interest 19.3548%) interest and ownership in GAOR and GAOR's Charter Capital at the moment the Third Contribution is received in GAOR's account. GAOR, GBOSC, Georgian Oil and Argonaut undertake to register CanArgo's increased interest in GAOR within two weeks of receiving the Contribution.
- d) On or before 31st January 1999 CanArgo shall make its Fourth and final Contribution and transfer the sum of \$360,000 as investment to GAOR's account, and the Charter Capital of GAOR shall be increased by \$2,273 to \$39,474 with CanArgo paying \$2,273 into the Charter Capital. For this

contribution CanArgo shall gain a further 4.6451% interest (total interest 24%) interest and ownership in GAOR and GAOR's Charter Capital at the moment the Fourth Contribution is received in GAOR's account, and the Charter Capital shall be \$39,474. GAOR, GBOSC, Georgian Oil and Argonaut undertake to register CanArgo's increased interest in GAOR within two weeks of receiving the Contribution.

- 6) Each owner of GAOR shall transfer 8% for CanArgo benefit, i.e. total CanArgo interest in GAOR will be 24%. The final ownership will than be Georgian Oil - 26%, GBOSC - 25%, CanArgo - 24% and Argonaut - 25%.
- 7) Georgian Oil, GBOSC, Argonaut and GAOR agree not to change the Charter Capital of GAOR without the written consent of CanArgo.
- 8) According to the Foundation Agreement the Board of Directors (the "Board") of GAOR currently consists of nine members. After CanArgo has made its First Contribution the Board of Directors of GAOR (the "Board") will be increased to ten members with the addition of one member from CanArgo, after CanArgo has made it's Second Contribution

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the Board shall be increased to eleven members with the addition of a further member from CanArgo (and in addition all decisions of the Board will require the concurring vote of at least nine members) and after CanArgo has made it's Fourth Contribution the Board shall be increased to twelve members with the addition of a further member from CanArgo, and after CanArgo has made it's Fourth Contribution the board shall be increased to twelve members with the addition of a further member from CanArgo. By mutual consent the number of board members may be reduced, but with the intention being that Georgian Oil, GBOSC, Argonaut and CanArgo are equally represented.

- 9) In the event that CanArgo does not meet a Contribution on or before the due date, CanArgo shall loose its rights to gain further interest in GAOR, but will retain the interest that it has already paid for.
- 10) The investment from CanArgo will be used exclusively for the purchase and installation of the Second Equipment, in the event that the purchase and installation and successful commissioning of the Second Equipment is achieved for a price less than \$1,860,000 ("Total Contribution") then any remainder will be used for the development of the Refinery or with the unanimous agreement Georgian Oil, GBOSC and Argonaut the excess may be split between Georgian Oil, GBOSC and Argonaut in proportion to their shares in GAOR as of the date of this AIP.
- 11) In the event that the cost of the purchase and installation of the Second Equipment exceeds \$1,860,000 then any additional finance requirement will be met by bank loans or sale of equity or by the shareholders in proportion to their equity ownership of GAOR at that time.
- 12) CanArgo accepts that it may be in the interests of GAOR for CanArgo's sister oil producing companies in Georgia to sell oil to GAOR. Within any restrictions or requirements imposed by other stakeholders in its sister companies, CanArgo will make efforts to do this, with the price being based on the market price and according to mutually acceptable formula accepted for price

calculation.

- 13) In the event of any dispute arising out of this AIP, the Parties shall use their best endeavours to settle such disputes, but in the event that such disputes cannot be resolved in this manner, then the issue shall be referred to arbitration, this to be held in English under UNCITRAL rules, and take place in Stockholm, Sweden.
- 14) This AIP is subject to CanArgo being satisfied with its legal opinions on the GAOR foundation documents, licences and any shareholder agreements, loan agreements or similar.

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- 15) GAOR will provide a monthly financial statement to the shareholders showing a balance sheet, income statement and a sources and application of funds statement.
- 16) Any shareholder or his agent will be given access to all books and records of GAOR upon request.
- 17) GAOR will have an annual audit.
- 18) CanArgo's obligations under this AIP are subject to CanArgo being satisfied with and its legal opinions on the GAOR foundation documents, licences and any shareholder agreements, loan agreements or similar and the August 31, 1998 financial statement. The provision of the first advance does not signify that CanArgo is or is not satisfied with these opinions. CanArgo will perform its due diligence by __October 31, 1998__ .

Signed, this the 26th day of August 1998

For Argonaut Oil & Gas

/s/Eugene Kozlowski
President

For GBOSC

/s/Shalva Bakhtadze
General Director

For CanArgo Petroleum Products

/s/Michael Binnion
Director

For Georgian Oil

/s/Revaz Tevzadze
Chairman

For GAOR

/s/Givi Assatiani
General Director

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[LETTERHEAD OF GAOR]

FAX

To: Mr David Robson Chairman & CEO CanArgo
Fax: 44 1481729982
Phone: 44 1481729980
Re: Extension of Payment.

From: Mr Givi Asatiani GAOR
Pages: 2
Date: 10 February, 1998
CC: Mr M. Binnion

- - Comments:

Dear Mr Robson,

Further to your letter of 14/12/98 regarding the extension of payment term to GAOR, I would like to inform you on the following.

Under the Agreement concerning the Participation by CanArgo in the Georgian American Oil Refinery, CanArgo will gain 24% interest and ownership, if it makes the payment of \$1,860,000 according to the following fixed schedule:

12.09.98 \$500,000
19.10.98 \$500,000
31.12.98 \$500,000
31.01.99 \$360,000

As of today CanArgo's payment mounts to \$1 M, accordingly CanArgo has gained 12,9032% interest and ownership.

Further to the GAOR founders' agreement, I would like to inform you that GAOR gives its consent to extend the payment term until 30th April 1999. Therefore, CanArgo keeps its right of 24% interest and ownership in GAOR during that period.

We believe that the participation of CanArgo will be a step forward in the successful development of GAOR project.

Best regards,

/s/Givi Asatiani
General Director

Georgian American Oil Refinery
Tel/fax: (99532) 920507
Gardabani, Sartitchala - Georgia

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</TEXT>
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<TYPE>EX-10.22
<SEQUENCE>7
<DESCRIPTION>TERRENEX ACQUISITION CORPORATION OPTION
<TEXT>

<PAGE> 1

EXHIBIT 10(22)

TERRENEX ACQUISITION CORPORATION OPTION REGARDING CANARGO (NAZVREVI) LIMITED

[Letterhead of Terrenex Acquisition Corporation]

May 7, 1998

David Robson
Chairman
CanArgo Energy Inc.
St. Peter Port, Guernsey

Dear Dr. Robson:

This letter confirms the terms and conditions under which Terrenex is prepared to advance up to \$1,000,000 US to CanArgo.

| | |
|--------------------|---|
| Use of proceeds | To participate in the May 10, 1998 tender for oil and gas licenses in Dagestan, cash calls for operations in Georgia and working capital. |
| Funds availability | May 1, 1998 |
| Repayment date | August 31, 1998 |
| Draw down fee | 5% of funds drawn (netted from the advance) |
| Commitment fee | 1% (\$10,000 payable from the first advance) |
| Interest rate | 1/2% per month payable in arrears |
| Bonus | Terrenex will have the sole option upon 30 days notice any time before December 31, 1998 to participate in 12 1/2% of the Block XIII/Nazvrevi license and/or 15% of the CanArgo position in any licenses (direct or indirect) in Dagestan received on the May 10, 1998 tender. Should Terrenex exercise this option it will have the obligation to pay its share of any past or future third party verifiable costs relating to the acquisition or development of the licenses on an unpromoted basis and before management fees. |
| Overdue amounts | Interest will accrue at the rate of 2% per month on any overdue amounts. |

<PAGE> 2

If you are in agreement with the above please sign where indicated below and we will ensure that funds are available.

Yours truly,

/s/M.R. Binnion, President

We agree with the above terms and request an immediate advance of \$250,000 US.

/s/Dr. David Robson

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<PAGE> 3

[Letterhead of Terrenex Acquisition Corporation]

TO: David Robson

FROM: Michael Binnion

SUBJECT: Options

DATE: December 17, 1998

Dear David:

As you know Terrenex Acquisition Corp. is working to form a syndicate to provide a letter of credit as support to the CanArgo IFC loan. I have made you personally aware of the efforts of Terrenex Acquisition Corp. in this regard.

The board of Terrenex Acquisition Corp. has requested that in consideration of the efforts currently being made by us that CanArgo grant a three month

extension on our options over the Dagestan and Nazvrevi projects. As you know Terrenex Acquisition Corp. has been consistently a strong supporter of CanArgo and I hope you will be able to grant this extension.

Best regards,

/s/M.R. Binnion

CanArgo hereby agrees to a three month extension to March 31, 1999 of the Terrenex Acquisition Corp. options over the Dagestan and Nazvrevi projects.

/s/David Robson, Chairman & CEO

3

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EXHIBIT 21

CANARGO ENERGY CORPORATION

LIST OF SUBSIDIARIES

As of December 31, 1998

<TABLE>
<CAPTION>

| Name ---- | Jurisdiction of Incorporation ----- |
|--|--|
| <S> | <C> |
| CanArgo Oil & Gas, Inc. | Alberta, Canada |
| Electromagnetic Oil Recovery International, Inc. | Alberta, Canada |
| Focan Ltd. | Alberta, Canada |
| Fountain Oil Adygea Incorporated | Delaware |
| Fountain Oil Boryslaw Incorporated | Delaware |
| Fountain Oil Boryslaw Limited | Cyprus |
| Fountain Oil Norway AS | Norway |
| Fountain Oil Production Incorporated | Delaware |
| Fountain Oil Services Ltd. | Bermuda |
| Fountain Oil Ukraine Ltd. | Alberta, Canada |
| Fountain Oil U.S., Inc. | Oklahoma |
| Gastron International Ltd. | British Virgin Islands |

Uentech Corporation

Oklahoma

UK-RAN Oil Corporation

Alberta, Canada

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<TYPE>EX-23.1

<SEQUENCE>9

<DESCRIPTION>CONSENT OF PRICEWATERHOUSECOOPERS LLP

<TEXT>

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EXHIBIT 23(1)

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the inclusion in this Registration Statement of CanArgo Energy Corporation on Form S-1, of our report which includes a paragraph regarding the ability of Fountain Oil Incorporated to continue as a going concern, dated March 9, 1998 (except for the sixth paragraph of Note 6, as to which the date is June 8, 1998, and for the first paragraph of Note 1, as to which the date is February 11, 1999) on our audit of the consolidated financial statements of Fountain Oil Incorporated as of December 31, 1997, December 31, 1996 and August 31, 1996, and for the year ended December 31, 1997, the four-month period ended December 31, 1996, and the years ended August 31, 1996 and 1995. We also consent to the reference to our firm under the caption "Experts."

/s/PricewaterhouseCoopers L.L.P.
PricewaterhouseCoopers L.L.P.

Houston, Texas

February 11, 1999

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<TYPE>EX-23.2

<SEQUENCE>10

<DESCRIPTION>CONSENT OF ERNST & YOUNG, CALGARY, CANADA

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EXHIBIT 23(2)

[LETTERHEAD OF ERNST & YOUNG]

REPORT OF INDEPENDENT CHARTERED ACCOUNTANTS

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated February 18, 1998 with respect to the consolidated financial statements of CanArgo Oil and Gas Inc. (formerly "CanArgo Energy Inc.") included in the Registration Statement (Form S-1) and related prospectus of CanArgo Energy Corporation for the registration of up to 21,264,643 shares of its common stock.

/s/Ernst & Young LLP
Chartered Accountants

Calgary, Canada

February 12, 1999

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<SEQUENCE>11
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EXHIBIT 23(3)

[LETTERHEAD OF ERNST & YOUNG]
REPORT OF INDEPENDENT CHARTERED ACCOUNTANTS

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated February 18, 1998 with respect to the financial statements of Ninotsminda Oil Company Limited (formerly "JKX (Ninotsminda) Limited") included in the Registration Statements (Form S-1) and related prospectus of CanArgo Energy Corporation for the registration of up to 21,264,643 shares of its common stock.

/s/Ernst & Young
Ernst & Young
Chartered Accountants

Limassol, Cyprus
February 12, 1999

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<PAGE> 1

EXHIBIT 23(4)

[LETTERHEAD OF AMH GROUP LTD.]
CONSENT OF INDEPENDENT PETROLEUM CONSULTANTS

With respect to our report dated February 9, 1999 entitled "Evaluation of the Ninotsminda Oil Interests Owned By CanArgo Energy Corporation", we hereby consent to the use of our name under the caption "Experts" and references to experts from the aforementioned document to be included in or made part of the Form S-1 registration statement filed by CanArgo Energy Corporation.

AMH Group Ltd.

/s/Robin C. Mann
Robin C. Mann
Executive Vice President

Calgary, Alberta, Canada

February 11, 1999

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| <PERIOD-END> | JUN-30-1998 |
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| <INVENTORY> | 36,369 |
| <CURRENT-ASSETS> | 11,448,864 |
| <PP&E> | 9,135,303 |
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| <TOTAL-LIABILITY-AND-EQUITY> | 23,661,883 |
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| <TOTAL-REVENUES> | 144,516 |
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| <TOTAL-COSTS> | 177,627 |
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| <INTEREST-EXPENSE> | 323,272 |
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| <PERIOD-END> | MAR-31-1998 |
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| <PERIOD-END> | DEC-31-1997 |
| <CASH> | 14,164,177 |
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| <INVENTORY> | 32,299 |

| | |
|------------------------------|--------------|
| <CURRENT-ASSETS> | 24,626,081 |
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| <TOTAL-ASSETS> | 37,434,035 |
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| <OTHER-SE> | 25,656,882 |
| <TOTAL-LIABILITY-AND-EQUITY> | 37,434,035 |
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| <TOTAL-REVENUES> | 313,301 |
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| <TOTAL-COSTS> | 1,953,487 |
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| <INTEREST-EXPENSE> | 69,286 |
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9-MOS

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DEC-31-1997

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JAN-01-1997

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SEP-30-1997

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18,880,080

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9,260,582

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47,664,769

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49,932,840

<SALES>

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| | |
|---------------------|-------------|
| <TOTAL-REVENUES> | 172,818 |
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| <TOTAL-COSTS> | 931,255 |
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| <INTEREST-EXPENSE> | 25,587 |
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| <PERIOD-END> | JUN-30-1997 |
| <CASH> | 19,987,309 |
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| <RECEIVABLES> | 407,760 |
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| <CURRENT-ASSETS> | 21,484,353 |
| <PP&E> | 9,311,470 |
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| <TOTAL-ASSETS> | 52,329,200 |
| <CURRENT-LIABILITIES> | 1,166,465 |
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| <COMMON> | 1,122,374 |
| <OTHER-SE> | 49,914,425 |
| <TOTAL-LIABILITY-AND-EQUITY> | 52,329,200 |
| <SALES> | 0 |
| <TOTAL-REVENUES> | 109,660 |
| <CGS> | 0 |
| <TOTAL-COSTS> | 461,903 |
| <OTHER-EXPENSES> | 1,442,410 |
| <LOSS-PROVISION> | 0 |
| <INTEREST-EXPENSE> | 67,332 |
| <INCOME-PRETAX> | (3,425,408) |
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| <PERIOD-END> | MAR-31-1997 |
| <CASH> | 25,227,861 |
| <SECURITIES> | 0 |
| <RECEIVABLES> | 564,919 |
| <ALLOWANCES> | 0 |
| <INVENTORY> | 0 |
| <CURRENT-ASSETS> | 26,758,290 |
| <PP&E> | 9,510,229 |
| <DEPRECIATION> | 635,161 |
| <TOTAL-ASSETS> | 54,073,397 |
| <CURRENT-LIABILITIES> | 1,461,805 |
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| <COMMON> | 1,120,574 |
| <OTHER-SE> | 51,326,464 |
| <TOTAL-LIABILITY-AND-EQUITY> | 54,073,397 |
| <SALES> | 0 |
| <TOTAL-REVENUES> | 31,916 |
| <CGS> | 0 |
| <TOTAL-COSTS> | 186,277 |
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| <INTEREST-EXPENSE> | 22,278 |
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| <PERIOD-START> | SEP-01-1996 |
| <PERIOD-END> | DEC-31-1996 |
| <CASH> | 31,424,064 |
| <SECURITIES> | 0 |
| <RECEIVABLES> | 259,889 |
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| <INVENTORY> | 232,773 |
| <CURRENT-ASSETS> | 32,305,515 |
| <PP&E> | 8,371,589 |
| <DEPRECIATION> | 605,110 |
| <TOTAL-ASSETS> | 55,375,061 |
| <CURRENT-LIABILITIES> | 1,924,410 |
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| <PREFERRED-MANDATORY> | 0 |
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| <COMMON> | 1,108,424 |
| <OTHER-SE> | 52,136,847 |
| <TOTAL-LIABILITY-AND-EQUITY> | 55,375,061 |
| <SALES> | 0 |
| <TOTAL-REVENUES> | 16,980 |
| <CGS> | 4,052 |
| <TOTAL-COSTS> | 319,702 |
| <OTHER-EXPENSES> | 1,398,824 |
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| <INTEREST-EXPENSE> | 12,744 |
| <INCOME-PRETAX> | (2,604,455) |
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| <PERIOD-START> | SEP-01-1995 |
| <PERIOD-END> | AUG-31-1996 |

| | |
|------------------------------|-------------|
| <CASH> | 17,329,237 |
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| <RECEIVABLES> | 8,061 |
| <ALLOWANCES> | 0 |
| <INVENTORY> | 18,373 |
| <CURRENT-ASSETS> | 17,985,554 |
| <PP&E> | 7,143,168 |
| <DEPRECIATION> | 565,603 |
| <TOTAL-ASSETS> | 32,088,541 |
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| <PREFERRED-MANDATORY> | 0 |
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| <OTHER-SE> | 29,636,160 |
| <TOTAL-LIABILITY-AND-EQUITY> | 32,088,541 |
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| <TOTAL-COSTS> | 42,979 |
| <OTHER-EXPENSES> | 1,777,915 |
| <LOSS-PROVISION> | 0 |
| <INTEREST-EXPENSE> | 1,016,465 |
| <INCOME-PRETAX> | (6,493,552) |
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| <CASH> | 4,791,645 |
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| <ALLOWANCES> | 105,224 |
| <INVENTORY> | 17,946 |
| <CURRENT-ASSETS> | 5,290,601 |
| <PP&E> | 1,063,200 |
| <DEPRECIATION> | 533,369 |
| <TOTAL-ASSETS> | 10,710,322 |
| <CURRENT-LIABILITIES> | 1,102,432 |
| <BONDS> | 0 |
| <PREFERRED-MANDATORY> | 0 |

| | |
|------------------------------|-------------|
| <PREFERRED> | 0 |
| <COMMON> | 541,703 |
| <OTHER-SE> | 9,066,187 |
| <TOTAL-LIABILITY-AND-EQUITY> | 10,710,322 |
| <SALES> | 464,044 |
| <TOTAL-REVENUES> | 625,457 |
| <CGS> | 479,224 |
| <TOTAL-COSTS> | 479,224 |
| <OTHER-EXPENSES> | 4,016,643 |
| <LOSS-PROVISION> | 0 |
| <INTEREST-EXPENSE> | 28,475 |
| <INCOME-PRETAX> | (7,571,011) |
| <INCOME-TAX> | 28,600 |
| <INCOME-CONTINUING> | (7,599,611) |
| <DISCONTINUED> | 0 |
| <EXTRAORDINARY> | 0 |
| <CHANGES> | 0 |
| <NET-INCOME> | (7,599,611) |
| <EPS-PRIMARY> | (1.82) |
| <EPS-DILUTED> | (1.82) |

</TABLE>

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</SEC-DOCUMENT>

-----END PRIVACY-ENHANCED MESSAGE-----